European
Commission

ISSN 2443-8014 (online)

European Economic Forecast

Winter 2019 (Interim)

INSTITUTIONAL PAPER 096 | FEBRUARY 2019

EUROPEAN ECONOMY

Economic and
Financial Affairs

European Commission
Directorate-General for Economic and Financial Affairs

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Institutional Paper 096

CONTENTS

LIST OF TABLES

LIST OF GRAPHS

GROWTH MODERATES AMID HIGH UNCERTAINTY

Economic activity in the EU and the euro area moderated last year on the back of a combination of internal and external factors. While a moderation of growth was already in the cards, the slowdown in the second half of 2018 turned out to be more pronounced than expected. Growth in the euro area slipped to 0.2% in the last two quarters of 2018 and the latest high frequency data suggest that this weak momentum continued in January 2019. Over the next two years, the economy is expected to continue growing but at a slower pace. Outside the EU, activity is also slowing down amid high uncertainties, and the outlook varies for different parts of the world.

The slowdown over the course of 2018 reflects fading support from the external environment, as increased uncertainty regarding trade policies, notably between the US and China, and a declining trend in global manufacturing output translated into weaker global trade growth. The euro area appears to be particularly impacted given the geographical orientation of its external trade and its product specialisation. Specific domestic factors also contributed to the loss of growth momentum in the second half of the year. These include the disruption of car production in the third quarter, which has since only partially rebounded, as well as social tensions and fiscal policy uncertainty in some Member States. Despite these developments, the fundamentals of the European economy remain sound. Improving labour market conditions, low financing costs and a slightly expansionary fiscal policy stance this year should allow the expansion to continue, but at a more moderate pace.

Overall, the GDP growth forecast for the euro area in 2019 has been revised down by 0.6 pps. since the autumn forecast to 1.3%. This revision mirrors a weaker carry-over from the last quarters of 2018 and a slightly weaker momentum in 2019. Next year, economic growth is expected to settle at 1.6%, i.e. 0.1 pps. lower compared to the autumn forecast. Euro area headline inflation declined at the end of 2018 on the back of a sharp drop in energy prices. The resulting base effects for this year and lower assumptions about oil prices entail a downward revision of euro area headline inflation to 1.4% in 2019. A very gradual pick-up in inflation is expected in 2020 (1.5%).

The outlook for the EU's economic growth is, however, predicated on receding uncertainties and a gradual unwinding of temporary domestic factors currently holding back domestic growth. Risks remain substantial and mainly stem from potential policy mistakes across the globe. Even if easing somewhat, trade tensions and the uncertainty surrounding their evolution still pose high risks for the global economy. In the US, the risk of an abrupt fiscal tightening appears to have increased, especially for 2020. The Chinese economy might be slowing more sharply than anticipated while many emerging markets are still vulnerable to sudden changes in global risk sentiment. Global financial markets remain exposed to further changes in perceptions of global growth prospects and investor appetite for risk, which would in turn have repercussions on the global economy. In the euro area, the risks of a resumption of negative sovereign-bank loops remain in some Member States. Temporary factors currently holding back growth could turn out to be more lasting than expected. Finally, large uncertainty still surrounds Brexit. On the positive side, a more extensive use of EU funds in recipient countries could trigger additional investments and the still favourable labour market conditions could result in stronger domestic demand.

Table 1:
Overview - the Winter 2019 (interim) forecast

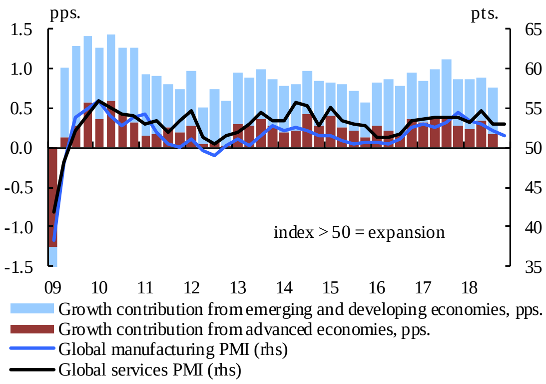
	Real GDP						Inflation					
	Winter 2019 forecast			Autumn 2018 forecast			Winter 2019 forecast			Autumn 2018 forecast		
	2018	2019	2020	2018	2019	2020	2018	2019	2020	2018	2019	2020
Euro area	1.9	**1.3**	**1.6**	*2.1*	***1.9***	***1.7***	1.7	**1.4**	**1.5**	1.8	**1.8**	**1.6**
EU27	2.1	**1.5**	**1.8**	2.2	**2.0**	**1.9**	1.8	**1.6**	**1.7**	1.8	**1.9**	**1.7**
EU28	1.9	**1.5**	**1.7**	*2.1*	***1.9***	***1.8***	1.9	**1.6**	**1.8**	2.0	**2.0**	**1.8**

1. EURO AREA AND EU OUTLOOK

1.1. GLOBAL GROWTH SLOWS AMID HIGH UNCERTAINTY

The global economy is slowing down following a period of sustained above-potential growth in many major economies. Global growth moderated to 0.8% q-o-q in the third quarter of 2018 (from 0.9% q-o-q in the second quarter, see Graph 1.1) and continued to vary across countries and regions. Activity in some advanced economies was weaker than expected, especially in the euro area and Japan, and signs of a slowdown in China became more apparent. On the other hand, economic growth in the US, India and emerging Asia remained solid. High frequency indicators paint a mixed picture of the global growth outlook in the short term, with robust global services PMI (purchasing managers index) readings on the one hand and a downward trend in global manufacturing output on the other.

Graph 1.1: **Growth of global GDP and PMIs**



Source: OECD, IMF and national statistical institutes for GDP, JPMorgan/IHS Markit for PMI.

Global GDP (excluding the EU) is estimated to have grown by 3.9% in 2018, 0.1 pps. lower than projected in the autumn. However, the outlook for this year and next remains broadly unchanged, with global GDP expected to expand at a solid pace of 3.8% for both years. (see Table 1.1).

The US economy is expected to grow above potential in 2019 on the back of a buoyant labour market and fiscal stimulus. However, the political gridlock in Congress that brought the government to a partial shutdown for more than a month is expected to weigh on consumer sentiment and growth in the beginning of the year. In 2020, the pace of growth is set to moderate as support from macroeconomic policies fades. In China, recent data confirm a loss of growth momentum, with uncertainty about the outcome of US-China trade negotiations and about the effectiveness of domestic policy stimulus weighing on the short-term outlook. The Chinese economy is thus expected to continue cooling, amid moderating consumption growth, weaker export growth and a slowdown in the property sector. Economic activity in other emerging market economies is expected to remain differentiated. Growth in Latin America and South Africa is expected to pick up following a weak 2018, while the decline in oil prices since the autumn has worsened prospects for oil exporters such as Russia and the OPEC.

Global import volumes (outside the EU) are expected to have risen by 4.8% in 2018, a moderate slowdown compared to 2017. This solid performance reflects robust underlying trade dynamics, strong global growth and frontloading of trade between the US and China in expectation of tariff measures. However, the uncertainty created by lingering trade tensions may have contributed to the slowing down of trade flows observed in recent months. For 2019 and 2020, global import growth (excluding the EU) is likely to moderate to 3.9% and 3.6% respectively, reflecting unresolved trade tensions as well as indications of declining global manufacturing output and, more broadly, the rising uncertainty over global growth in the medium-term. On the positive side, trade agreements that entered into

Table 1.1:
International environment

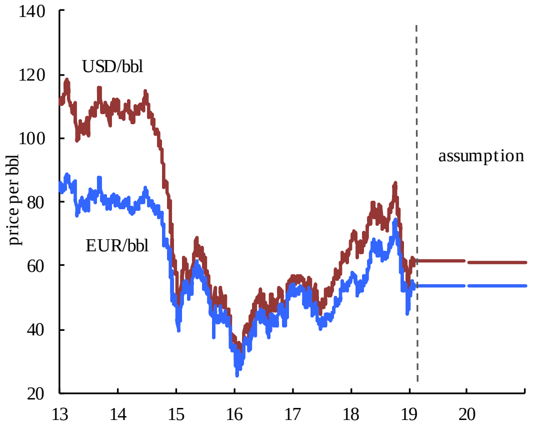
(Annual percentage change)				Winter interim 2019 forecast			*Autumn 2018 forecast*		
	2015	**2016**	**2017**	**2018**	**2019**	**2020**	***2018***	***2019***	***2020***
					Real GDP growth				
World (excl.EU)	3.5	3.4	3.9	**3.9**	**3.8**	**3.8**	*4.0*	*3.8*	*3.8*
					Merchandise trade volumes				
World (excl.EU) exports of goods and services	1.5	2.0	5.2	**4.3**	**3.7**	**3.4**	*4.2*	*3.7*	*3.4*
World (excl.EU) imports of goods and services	0.5	1.2	5.5	**4.8**	**3.9**	**3.6**	*4.8*	*4.0*	*3.7*

force recently such as the bilateral agreement between the EU and Japan or the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) should support global trade (see technical box for a recent review of trade policies).

Substantially lower oil prices than expected in the autumn

Over the last few months, oil prices tumbled on investor concerns about the global economic outlook and higher-than-expected supply from Iran (due to US sanction waivers). The price of Brent crude finished 2018 at around USD 55/bbl but has since recovered slightly following Saudi Arabia's intention to reduce oil exports. Over the forecast horizon, upward price pressures are expected to be held down by growing production in the US and Canada and a moderation in global oil demand as the global economy gradually shifts to a lower gear. Based on futures markets, an average Brent oil price of USD 61/bbl is now assumed in 2019 and 2020. This is 24% less than in the autumn forecast for 2019 and 20% less for 2020 (see Graph 1.2).

Graph 1.2: **Oil price assumptions**



1.2. FINANCIAL MARKETS CONTINUE TO ADJUST AMID HIGH VOLATILITY

With fading expectations of (further) monetary policy normalisation in 2019…

While monetary policy normalisation in the US went on last year, expectations of further tightening have been significantly fading in recent months. The US Federal Reserve raised the target range for the Fed funds rate to 2.25%-2.50% in December 2018, tightening its policy rate for the fourth time in a year. US monetary policymakers then signalled that some further gradual increases in the target range for the Fed funds rate could be required over the medium term. At the same time, the minutes of the meeting revealed that most board members were inclined to show patience and to focus on the data, given the current stage in the monetary cycle. In January, the US Federal Reserve kept its Fed funds rate unchanged and took a more dovish tone on the path of interest rates and showed willingness to slow the unwinding of its balance sheet. This was interpreted as a concern by the Fed regarding the rapid deceleration in global liquidity over the last two quarters and its possibly negative consequences on financial stability and the real economy. Meanwhile, market-implied policy rate expectations have moved lower, suggesting that no additional interest rate hikes are expected in the US in 2019.

In the euro area, the ECB's monetary policy has remained highly accommodative. While the ECB decided to end its net asset purchases in December 2018, significant monetary policy stimulus was still considered necessary to support the further build-up of domestic price pressures and inflation over the medium term. The necessary degree of monetary accommodation will be provided by the forward guidance on the ECB policy rates and the reinvestments of the sizeable stock of acquired assets going forward.([1]) Thus, key ECB interest rates are expected to remain at their present levels at least through the summer of 2019. Also, the nature of the ECB's forward guidance, which is both data and state-dependent, should help provide additional accommodation if necessary (i.e. should the economic outlook worsen in the euro area).

…the euro has weakened slightly since the beginning of this year.

While the euro has weakened somewhat (about 1%) in nominal effective terms over recent months, it has remained broadly stable against the US dollar since mid-November 2018. The weakening in nominal effective terms took place on account of the euro's depreciation against the Japanese yen and the pound sterling but also vis-à-

([1]) The ECB also decided at its December 2018 meeting to enhance its forward guidance on reinvestments which now states that the ECB intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the asset purchase programme for an extended period of time past the date when it will start raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

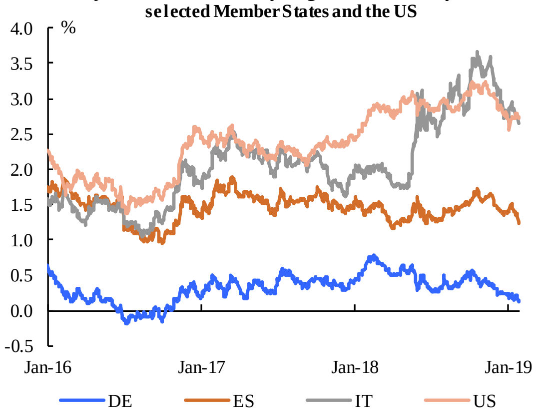
vis a number of currencies of major emerging economies (e.g. China, Russia).

Financial markets have been shaken by weaker incoming data and policy news...

Global financial market prices have shown high volatility over the last few months, reflecting evolving perceptions of the mix of data and policy news. Market sentiment has been soured by concerns about global growth in a context of high indebtedness, trade tensions and policy uncertainty. On the back of the re-assessment of the underlying global economic outlook and more dovish messages from key central banks, investors shifted from riskier assets to safer ones, driving equity markets and sovereign bond yields lower.

Sovereign benchmark yields declined and yield curves flattened([2]) over the fourth quarter of 2018 as more evidence emerged of slowing global growth and as markets lowered their expectations about the pace of monetary policy tightening. Euro area sovereign bond spreads (relative to German Bunds) narrowed, as risk perceptions eased. However, idiosyncratic factors continued to play a major role. Italian spreads widened sharply following the presentation of the Italian budget in October 2018, but narrowed significantly after the government reached an agreement with the European Commission on an amended budget (see Graph 1.3).

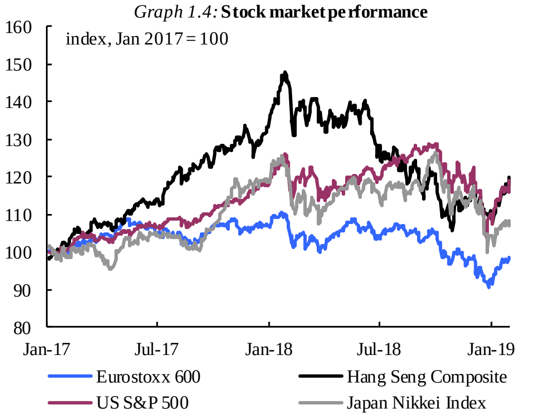
Graph 1.3: **Benchmark 10-year government bond yields, selected Member States and the US**



Source: Macrobond.

Global stock markets experienced a significant correction in the last quarter of 2018 (see Graph 1.4). Global growth concerns, trade tensions between the US and China, and worsening corporate earnings reports affected market sentiment. Markets rebounded in January, driven by a more favourable mix of data and more benign policy news (e.g. more dovish messages from the US Fed, the Italian government lowering its 2019 budget deficit plan and renewed negotiations between the US and China on tariffs). In Europe, the banking sector index underperformed significantly amid a flattening yield curve.

Graph 1.4: **Stock market performance**



Source: Macrobond.

European corporate bonds spreads have widened over the last few months as markets have been pricing in greater risks. The upward price movement has been stronger for high yield corporate bonds, reflecting concerns about excessive leveraged lending and the level of corporate debt.

...but funding flows remain strong.

The volatility in asset prices notwithstanding, financing conditions have remained very benign overall. Lending flows to households and non-financial corporations (NFCs) in the euro area have been robust. The annual growth rate of loans to non-financial corporations stood at 4.0% in December 2018, while that to households stood at 3.3%. The January 2019 ECB Bank Lending Survey points to broadly unchanged credit standards in 2018-Q4 after a long period of overall easing. According to the surveyed banks, demand for loans rose in late 2018 although banks expect some moderation this year.

Overall, households and NFCs are expected to continue to benefit from supportive financing conditions in 2019 and 2020. Also, the euro area corporate sector continues to run funding surpluses generating sizeable internal funds, which could be used to finance investment.

([2]) In the US, the yield curve has even inverted occasionally within the two to five years maturities range.

1.3. THE EXPANSION LOSES STEAM

Growth stumbled last year...

The euro area economy finished 2018 on a weak footing, having failed to rebound from the drop in growth over the summer. As a result, euro area and EU GDP growth in the second half of last year turned out lower than expected in the autumn forecast ([3]).

After four quarters of 0.7% (q-o-q) GDP growth in 2017, growth moderated to 0.4% in the first two quarters of 2018. The slowdown intensified in 2018-Q3, with GDP expanding by 0.2% in the euro area. In the EU, GDP expanded by 0.3% in the third quarter compared to 0.5% in the second. While a moderation of growth was already in the cards, the slowdown in the second half of 2018 turned out to be more pronounced than expected. In 2018-Q3, Member States fared quite differently with, most notably, a contraction of activity in Germany (-0.2%) and Italy (-0.1%). According to Eurostat's preliminary flash estimate for 2018-Q4, euro area GDP ended the year on a weak note, growing by 0.2% (q-o-q) for the second consecutive quarter. Preliminary flash estimates were available for seven Member States, with only Italy registering a contraction (-0.2%).

...on the back of a combination of internal and external factors.

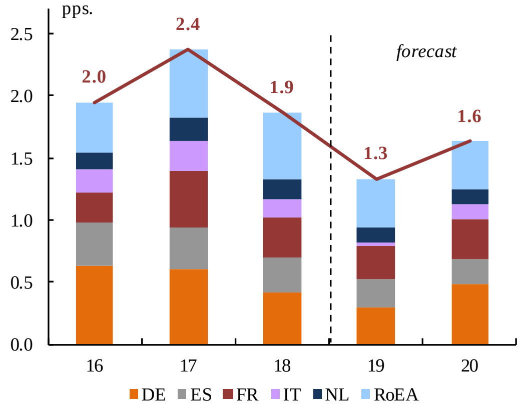
Much of the euro area's loss of growth momentum can be attributed to fading support from the external environment, including slower global trade growth and high uncertainty regarding trade policies. However, there have also been a number of domestic factors at play.

The European manufacturing sector has suffered from some specific factors. ([4]) Car production was significantly disrupted in the third quarter, particularly in Germany, where producers struggled to win certification under a new emission testing procedure (the Worldwide Light Vehicle Test Procedure), which became compulsory on 1 September. This led manufacturers to significantly reduce production in 2018-Q3. During the last quarter of the year, economic activity remained weak amid social tensions and budgetary-policy uncertainty in some Member States, while car production only partially recovered.

Euro area industrial production, however, was weak in 2018 and dropped sharply across sectors at the end of the year. As a result, the weakness of economic growth in the second half of 2018 cannot entirely be blamed on sector-specific or temporary factors.

For the year 2018 as a whole, GDP is estimated to have grown by 1.9% in both the euro area and the EU. The downward revision since the autumn reflects weaker-than-forecast growth in the last two quarters of 2018 (see Graph 1.5).

Graph 1.5: **Real GDP growth, euro area (contribution by Member States)**



Domestic demand softened in the third quarter...

The GDP breakdown for 2018-Q3 ([5]) shows that economic growth was supported by private consumption and investment, but, when excluding the contribution of inventories ([6]), it appears that the domestic drivers of the expansion in the euro area softened (see Graph 1.6).

Changes in inventories contributed significantly to growth in 2018-Q3 (+0.3 pps. from neutral in 2018-Q2). This mostly reflects developments in Germany, where the contribution reached its

([3]) See European Commission (DG ECFIN) (2018). European Economic Forecast – Autumn 2018. Institutional Paper 89.

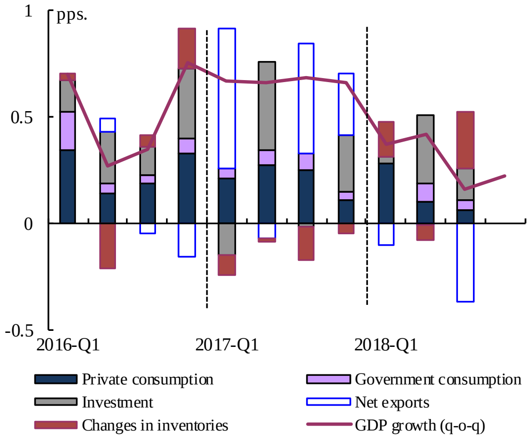
([4]) One-off and temporary factors, but also the unwinding of their effects, have clouded GDP readings in 2018. This included unusual weather, strikes in some Member States, the timing of the Easter holiday and a wave of influenza-related sick leaves in the first half of 2018.

([5]) The GDP breakdown for 2018-Q4 will be released on 7 March.

([6]) In contrast with faltering net exports, domestic demand (including inventories) growth remains broadly in line with its average since 2014.

highest since 2013-Q1, partly linked to the strong disruption in the German car industry. (7)

Graph 1.6: **Real GDP and its components, euro area**



Private consumption in the euro area lost some momentum in 2018-Q3 when its pace of growth slipped to 0.1% from 0.2% in the previous quarter. This reflects slower employment creation, (8) a decrease in consumer confidence, and an uptick in the saving rate. (9) The slowdown of private consumption was, however, not broad-based across the largest economies. While private consumption contracted in both Germany and Italy in the third quarter, it rebounded in France, Spain and the Netherlands following a soft patch in the previous quarter.

Investment weakened in the euro area in 2018-Q3 (from 1.6% q-o-q in 2018-Q2 to 0.7%), mainly as a result of a sharp drop in non-construction investment in Italy, a fall in construction spending in the Netherlands, and a slowdown in both France and Spain. The sharp pick-up in investment spending in Ireland (+21.8%), however, gave a sizeable positive contribution, as investment in the euro area excluding Ireland would have only increased by 0.2% during the quarter.

(7) See ECB (2012). 'Stockbuilding – theoretical considerations and recent developments'. ECB Monthly Bulletin, May, pp. 66-70.

(8) The number of persons employed increased by 0.2% in 2018-Q3 from 0.4% in the two first quarters of 2018. The key role of improving labour markets in private consumption growth is reflected in the contribution of labour income to households' disposable income growth, which was the strongest in a decade in the first half of 2018.

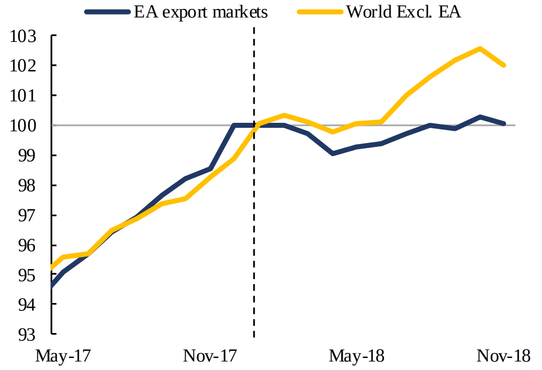
(9) The household saving rate in the euro area stood at 12.3% in 2018-Q3, up from the historically low level of 11.7% in 2017-Q3.

...and exports continued to underperform...

Euro area export growth weakened throughout 2018. In the third quarter, it dropped to 0.1% q-o-q (from 1.2% in 2018-Q2). The decline was particularly marked in Spain and Germany. The weak performance of euro area exports in 2018-Q3 was due to a drop in goods exports (-0.4% q-o-q), while service exports remained strong (+1.5% q-o-q).

Broken down geographically, extra-euro area goods exports dropped by 0.3% q-o-q in 2018-Q3 (-0.1% q-o-q in 2018-Q2), dragged down mainly by lower exports to Switzerland and Turkey. Intra-euro area exports contracted by a similar magnitude. (10) Given the geographical orientation of external trade and its product specialisation, the euro area appears to be particularly impacted by the softening/deceleration of world trade growth. This is reflected in the divergence between the growth in euro area export markets (11) and overall world import demand (excluding euro area) over the course of 2018 (see Graph 1.7).

Graph 1.7: **Export markets demand**
(Dec-17=100, 3-month moving average)



Source: CPB. Own calculations.

Import growth also slowed, but more gently than exports, resulting in a negative contribution of net exports to euro area GDP growth in the third quarter of 0.4 pps. This contrasts with 2017, when net exports posted a symmetrically positive contribution to euro area GDP growth.

(10) In annual terms, extra-euro area exports slowed down from +5.0% in 2017-Q3 to +1.1% in 2018-Q3, driven by a fading impetus of exports to China and a fall in exports to the United Kingdom, Turkey, Switzerland and Russia. Over the same period, intra-euro area exports slowed from +3.7% to +1.2%.

(11) Volume of goods imports by euro area exports markets weighed by shares in euro area exports of goods (source: CPB).

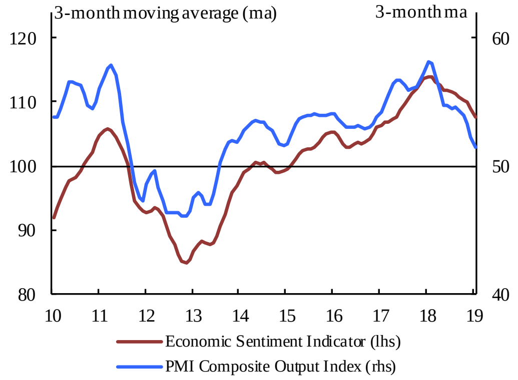
...while incoming data suggest that the lower momentum will last longer than initially expected.

The recent string of weak hard and survey data coupled with the softening of world trade and possibly protracted sector- and country-specific weaknesses in the euro area suggest that the strong momentum enjoyed throughout 2017 is now behind us.

Although the European Commission's Economic Sentiment Indicator (ESI) remains above its long-term average, it has decreased markedly in recent months. The drop in business confidence in December and January was broad-based across countries and sectors, except construction.

In parallel, the euro area Flash Composite Output Purchasing Managers' Index (PMI) fell in January 2019 to 50.7. Since its peak in January 2018, the PMI Index has fallen 8 pts. and is now at a 5½ year low (see Graph 1.8). While PMIs weakened across countries, both January's and December's readings were strongly influenced by the fall of the composite PMI in France, which was linked to the disruptions to business and travel arising from the 'yellow vests' protests.

Graph 1.8: **Economic Sentiment Indicator and PMI Composite Output, euro area**



Source: EC, IHS Markit

In November 2018, industrial production (excluding construction) in the euro area fell further by 0.5% 3m-o-3m, compared to -0.1% in 2018-Q3.

Despite robust labour market developments, private consumption remained muted in a number of Member States at the end of last year, possibly reflecting lower consumer confidence. The Commission's Consumer Confidence Indicator in the euro area rose slightly in January after dropping markedly in the last quarter of 2018 and still stands above its long-term average. This is in line with the Commission's Retail Trade Confidence Indicator, which also decreased in the fourth quarter, while remaining close to historically high levels.

Momentum in retail trade volumes geared up slightly in November (+0.2% 3m-o-3m), following an unchanged level in the third quarter. Car registrations fell markedly over the last quarter of the year (-11.4%, after +1.9% in 2018-Q3), hit by production problems in Germany following the implementation of new emission standards and possibly by the uncertainty created by bans on diesel vehicles in a number of cities. ([12]) Car sales were boosted in 2018-Q3 in anticipation of the imminent implementation of these new emission standards.

Investment dynamics in 2018 proved to be particularly vulnerable to the weakening external environment. ([13]) High-frequency indicators of business investment during the last quarter of 2018, however, were more benign. Despite weakening somewhat in November, industrial production of capital goods continued to display positive momentum (+1.0% 3m-o-3m in November in the euro area, +0.9% in 2018-Q3). While receding during the year, the capacity utilisation rate in industry remained at an above-average rate of 83.9% in 2018-Q4. The construction sector continues on a positive trend, as reflected by the Commission's Construction Confidence Indicator, which remained around its highest level since early-1990 after peaking in September.

Finally, the investment rate of non-financial corporations stood at 23.3% of gross value added in the third quarter, up by about 0.9 pps. from a year earlier. External funding, in particular bank lending, continued to be supportive for household house purchases, consumption spending and corporate investment. Business investment appears

([12]) Deutsche Bundesbank (2018). 'Outlook for the German economy – macroeconomic projections for 2019 and 2020 and an outlook for 2021'. *Monthly report*. December.

([13]) This was amplified by the high integration of the euro area economy in global value chains, reflected by the relatively elevated import content of its exports compared to other advanced economies. Also for the results of shock simulations see Buti, M., Chabin, A., Döhring, B. and Leal J. (2018), "Resilient growth amid increased uncertainty: The Commission's Summer Interim Forecast", VoxEU.org, 13 July.

therefore financially unconstrained despite a gradual decline in the corporate profit share.

Exports are expected to have remained subdued in the last quarter of 2018, in line with a further deterioration in the export order books component in the Commission's manufacturing survey. The same message emerges from Markit's Manufacturing PMI new export orders index, which entered 2019 in contractionary territory, suggesting continued underperformance in the months ahead.

Fundamentals remain supportive for domestic demand…

While the economy is shifting into a lower gear after having peaked in 2017, the fundamentals for continued growth remain in place. The European economy continues to benefit from improving labour market conditions, a slightly expansionary fiscal policy stance, and supportive financing conditions, as the pace of monetary policy normalisation is expected to be very gradual.

Over the forecast horizon, growth is projected to continue benefiting from a rotation towards domestic growth drivers. While the current weakness in economic activity is likely to extend into 2019, the growth momentum is expected to be stronger than in the second half of last year, as some of the temporary factors that weighed on growth during that period should fade.

Private consumption should remain the main growth driver, benefiting from continued but slower labour market improvements and a pick-up in wage growth. However, as spending tends to be more sensitive to changes in employment than in wages, households are expected to become gradually less inclined to consume additional labour income. Household purchasing power is also set to benefit from lower energy prices, while disposable incomes are expected to receive support from expansionary fiscal measures in a number of Member States. These factors, however, may not translate into more dynamic consumption patterns in the short term due to waning consumer confidence, which could lead to higher precautionary savings.

Investment is set to continue growing faster than GDP this year and next. According to the European Commission's latest investment survey, investment volumes in the euro area manufacturing sector are expected to remain buoyant, growing by 4.5% this year, following growth expectations of 5.0% in 2018.

Business investment should continue to enjoy financing conditions that are favourable by historical standards, even accounting for the recent pick-up in the risk premium. High capacity utilisation rates in manufacturing and tight supply conditions in some Member States should also support business investment. Pressure from high labour utilisation rates can also be expected to encourage firms to invest, smoothing the impact of more binding supply constraints, with positive effects on productivity growth. Moreover, the Investment Plan for Europe is expected to continue to boost investment through improved access to financing. ([14]) At the same time, residential investment should find support from the continued dynamism in real house prices and positive income prospects.

The impact of these supportive factors, however, is likely to be partly offset by rising supply hindrances, particularly in the construction sector and the end of targeted fiscal incentives in some Member States. Weaker sentiment, mounting uncertainty regarding the global outlook and lower demand growth are likely to weaken the impetus for investment, particularly in export-oriented sectors and countries.

Although a non-escalation of trade disputes is assumed, trade policy uncertainty and tensions are expected to weaken global trade growth. ([15]) The euro area is particularly vulnerable due to its trade openness and the current tensions are undermining business investment and slowing down the momentum of existing supply chains, with spillovers to the economy's long-term growth potential.([16])

([14]) As of December 2018, operations approved under the Investment Plan for Europe, were expected to trigger EUR 360 bn in investments. Around 850,000 small and medium-sized companies (SMEs) are expected to benefit from improved access to finance.

([15]) As in autumn, the direct impact of protectionist measures is expected to remain low and the outlook for trade in goods and services is based on the assumption that trade disputes will not escalate any further. What is expected to weigh on trade flows is the impact of the uncertainty generated by implemented, announced and threatened trade measures.

([16]) See Ebeke, C. and Siminitz, J. (2018). 'Trade uncertainty and investment in the euro area'. *IMF Working Paper* 21.

...but the short term outlook worsened.

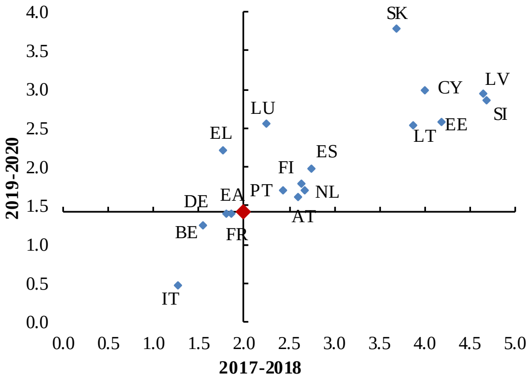
Overall, the growth outlook for this year and next has been revised downwards compared to the autumn forecast. This lower growth path in 2019 is strongly influenced by a weaker carry-over from 2018 and a slightly weaker quarterly momentum in 2019 compared with the autumn forecast. The slight pick-up in the quarterly profile forecast for 2019 assumes that some uncertainties will recede and that the temporary factors that held back growth in the latter half of 2018 will unwind. It also factors in a positive impact from fiscal measures in some Member States. GDP is now expected to grow by 1.3% this year in the euro area (1.5% in the EU).

In 2020, euro area GDP growth is forecast to rise to 1.6% (1.7% in the EU). Whereas the projected annual growth rate is slightly higher than in 2019, the quarterly growth profile is lower. This is explained by a higher number of working days in several Member States in 2020 ([17]) that will push up the annual growth of economic activity, but not the quarterly rates, which are working-day adjusted. The slight loss of momentum in 2020 visible in the quarterly profile is due to slower labour market improvements and more binding supply side constraints in some Member States, as well as weaker external demand.

Given the ongoing ratification process of the withdrawal agreement in the EU and the UK, projections for 2019 and 2020 are based on a purely technical assumption of status quo in terms of trading relations between the EU27 and the UK. This is for forecasting purposes only and has no bearing on the talks underway in the context of the Article 50 process.

While all Member States should continue to grow, growth in some Central and Eastern European economies is forecast to be particularly strong, which should contribute positively to the convergence of living standards in the EU. Despite their exposure to world trade and larger Member States through their integration in supply chains, these economies are expected to be only lightly affected by the slowdown in their major trading partners, at least in the short run. Tight labour markets coupled with robust domestic demand should fuel dynamic wage growth, consumption and private investment. Moreover, the absorption of EU funds is set to boost public investment. (see Graph 1.9)

Graph 1.9: **Real GDP growth, euro area and Member States, 2017-2018 versus 2019-2020**



Note: MT and IE are excluded from the calculation of the euro area average and are not displayed.

1.4. LABOUR MARKET CONDITIONS REMAIN A BRIGHT SPOT IN THE ECONOMIC EXPANSION

The euro area labour market improved further in the first three quarters of 2018. Employment rose by 0.2% q-o-q in 2018-Q3, following 0.4% growth in the two preceding quarters, implying an annual increase of 1.6%. The number of employed persons has reached the highest level ever recorded in the euro area ([18]), and is now about 2½% above the pre-crisis peak observed in the first quarter of 2008. Recently, the strongest increase in employment has been seen in the construction sector, whereas employment creation in manufacturing has come to a standstill. Despite this overall positive development in the euro area, the total number of hours worked in the economy remains below its pre-crisis level (by about 1% as compared to the first quarter of 2008) despite continuing to rise in line with job creation. This reflects the change in the composition of employment towards a higher share of part-time employment.

In December 2018, the unemployment rate in the euro area stood at 7.9%, its lowest level since October 2008. Unemployment continues to fall by more than the growth rate of the economy would suggest. In recent years, labour market conditions have improved across all Member States, but

([17]) Compared to adjusted figures, calendar effects are expected to add about 0.2 pps. to growth during the year due to a higher number of working days compared with the previous year.

([18]) In 2018-Q3, employment in the euro area stood at 146.459 million (223.991 million in the EU28) according to Eurostat (15-64 years old).

substantial differences in unemployment rates remain.

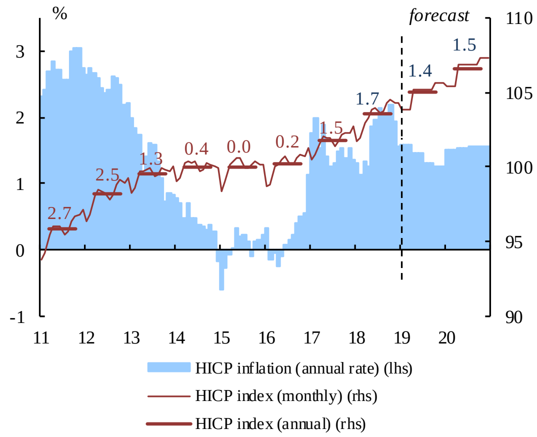
Forward looking labour market indicators have recently moderated somewhat. Survey indicators of firms' employment expectations remain consistent with continued but slower job creation in the fourth quarter of 2018 (Eurostat employment data are only available up to the third quarter) and in the period ahead, with the unemployment rate set to remain at relatively low levels. However, according to the European Commission's Business and Consumer Surveys, employment expectations have worsened up to January 2019 in manufacturing, services, and the retail sector, whereas they have been rather volatile in the construction sector. In all four sectors the latest readings remain above their long-term averages. At the same time, there are signs of labour shortages in some Member States and sectors, implying that employment growth in these economies will moderate.

1.5. ENERGY PRICES DRIVE INFLATION LOWER

After standing above 2% in the third quarter of 2018, headline inflation in the euro area dropped considerably in December to 1.6%, in line with movements in global energy prices. Energy price inflation went down from a high of 10.7% in October to 5.5% in December. Besides energy, inflation of food components also fell throughout the fourth quarter compared to the previous quarter. Headline inflation in the euro area averaged 1.9% in the fourth quarter of 2018, slightly below what was expected in autumn. For the year as a whole, euro area inflation averaged 1.7% in 2018, marginally below the autumn forecast and up from 1.5% in 2017.

While the muted underlying inflation rate largely reflects the lagged negative impact of a prolonged period of low inflation, it remains a puzzle as to why it has not responded yet to higher wage growth. Compensation per employee showed clear signs of pick-up, standing at 2.5% in 2018-Q3, increasing much more than the closely correlated services inflation rate. Moreover, prices along industrial supply chains were also rising steadily in 2018, with the growth of industrial producer prices having edged up above the 4% mark in the fourth quarter.

Graph 1.10: **HICP, euro area**

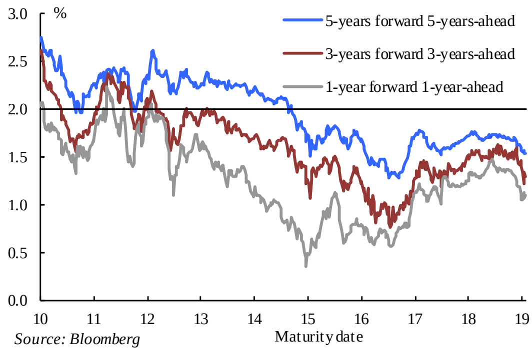


Figures next to horizontal bars are annual inflation rates.

Only a gradual increase in core inflation

Core inflation – which excludes energy and unprocessed food prices – remained muted with no discernible trend in 2018. The forecast for headline inflation in the euro area this year is revised lower compared to autumn mainly due to lower technical assumptions about the future price of oil and the resulting base effects. As a result, headline inflation is projected to follow a downward path in 2019 and to pick up very gradually in 2020. On average, inflation is forecast to moderate to 1.4% in 2019 and to tick up mildly to 1.5% in 2020. Underlying inflation is expected to rise gradually in 2020, as favourable labour market developments should remain supportive of solid wage growth, which is a key determinant of domestic price pressures, especially services inflation.

Graph 1.11: **Inflation expectations derived from implied forward inflation-linked swap rates, euro area**



Source: Bloomberg

Market-based measures of inflation expectations have trended lower in all spectrums since autumn and the beginning of this year, on account of the sharp drop in oil prices. At the cut-off date of this forecast, inflation-linked swap rates stood at around 1.1% at the one-year forward one-year-ahead horizon and at 1.3% at the three-year forward three-year-ahead horizon. On a longer horizon, the widely watched five-year forward five-year-ahead indicator suggests inflation of 1.5% (see Graph 1.11). Moreover, the ECB's January 2019 Survey of Professional Forecasters includes inflation forecast means of 1.5% in 2019 (down by 0.2 pps.), 1.6% in 2020 (down by 0.1 pps.) and 1.7% in 2021. Longer-term inflation expectations were revised slightly lower to 1.8%.

1.6. SUBSTANTIAL UNCERTAINTY REMAINS

At the current juncture, the EU economy is facing an exceptional amount of uncertainty related to trade policy, and more generally the future of multilateralism, but also on the domestic side, including the future of the EU's economic relationship with the UK. Uncertainty has been weighing on economic sentiment in recent months and could come to affect economic growth more than currently expected. Several important downside risks surround the central scenario of this winter interim forecast. Many of these risks appear interconnected and non-linear, which could magnify their impact on the economy if they were to materialise.

Trade tensions still weigh on the global economy...

Trade tensions between the US and China have recently eased but there is still high uncertainty around the nature and scope of the possible agreement between the two countries. The entry into force of trade agreements including the Trans-Pacific Partnership and the EU-Japan Economic Partnership Agreement should contribute to avoiding a generalised escalation of trade protectionism. Although the risk of further escalation of trade tensions appears to have somewhat receded over the last couple of months, it could still affect the global economic outlook. A related disruption of global value chains and lower growth prospects in China and the US could also lead to a re-assessment of financial market risks. The risk of a sharper economic slowdown in China remains elevated as the authorities face domestic policy constraints, mounting concerns about the effectiveness of policy stimuli, the possibility of further deterioration on the trade front, and the potential for weaker domestic demand.

In the US, the risk of an overheating economy and faster-than-expected monetary policy normalisation seems to have diminished recently as incoming data do not point to significant inflationary pressures. However, a divided Congress is expected to lead to greater uncertainty around fiscal policy deadlines, as proven by the recent partial government shutdown. In particular, the political stalemate raises doubts about the capacity of the US government to avoid a sharp fiscal tightening ('fiscal cliff') over the forecast horizon and in particular next year.

Financial market valuations have declined since the autumn, taking out some air from the high market valuations in several market segments. Still, further changes in perceptions about global prospects could trigger an additional, more abrupt correction with repercussions for the real economy. Many emerging markets remain vulnerable to sudden changes in global risk sentiment and a stronger US dollar. This could accelerate deleveraging and result in lower growth in those economies with knock-on effects on a global scale. However, the recent decline in global long term yields offer a respite to the risk of further financial turmoil in emerging markets.

...with uncertainty on the direction of policies also present in the EU

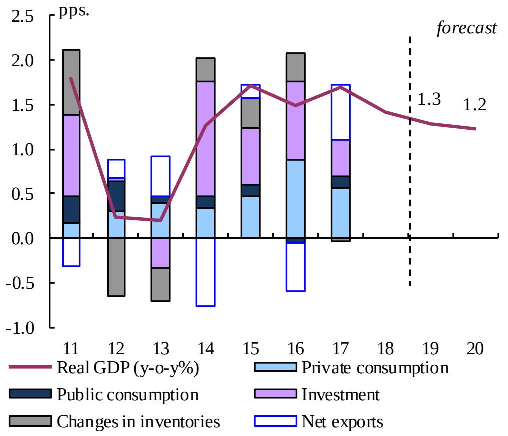
The outcome of the Brexit process will impact financial markets and investors. In case of a 'no deal', it would lead to a more disruptive impact on the EU-UK trade relationship and on economic activity in Europe than currently envisaged under the purely technical assumption about trade relations after the UK's exit from the EU used for this interim forecast. In the euro area, downside risks from financial tensions linked to the resumption of negative sovereign-bank loops persist. While such risks appear structural as long as the banking union architecture remains incomplete, they seem less pronounced in the current context of declining sovereign yields. The current temporary factors holding back growth, particularly the bottlenecks in the car industry, are expected to wane over the coming quarters. However, there is a risk that the slowdown in the car industry may also reflect longer-lasting factors such as uncertainty about driving bans for diesel cars and rapid technological change that may affect demand more durably. On the upside, rising supply constraints in some Member States and still favourable labour market conditions could result in stronger domestic demand while a more extensive use of EU funds in recipient countries could trigger additional investments.

2. PROSPECTS BY MEMBER STATES

2.1. BELGIUM

GDP growth eased in 2018 to 1.4%, from 1.7% in 2017, mainly due to slower private consumption and private investment growth. As in 2017, sustained net exports made a positive contribution to growth. Economic sentiment has deteriorated throughout the year across most sectors, although most confidence indicators remain above their long-term averages. Survey data point to expectations of weaker order books and slower employment growth.

Graph 2.1: **Belgium - Real GDP growth and contributions**



Domestic demand is forecast to be the main growth driver. Private consumption is expected to strengthen gradually as disposable income growth is supported by sound labour market conditions and personal income tax cuts. After a marked slowdown in 2018, private investment is set to pick up again but remain moderate. Household investment is projected to rise gently as interest rates are assumed to remain low. Business investment is also expected to continue growing amid favourable financing conditions and sound profitability, though more slowly than in recent years. Public investment should slow down in 2019, in line with the electoral cycle.

Despite sustained domestic demand, GDP growth is forecast to ease to 1.3% in 2019 and 1.2% in 2020. The contribution of net exports to GDP growth is forecast to weaken markedly in 2019 and even turn negative in 2020. While the expected slowdown in world trade is likely to weigh on exports, imports should find support from the strength of domestic demand. Downside risks are related to weaker-than-expected growth in Belgium's main trading partners, which could negatively affect investment and net exports.

Headline inflation remained high at 2.3% in 2018, driven by factors such as higher fossil fuel and wholesale electricity prices and rising food prices. Headline inflation is expected to ease to 1.9% in 2019 and 1.7% in 2020, reflecting the assumption of lower oil prices and lower expected increases in food prices. Weak competition in some business and professional services sectors is expected to contribute to slightly higher core inflation in 2019 and 2020, which will be reflected in automatic wage indexation. The inflation gap between Belgium and the euro area is projected to narrow gradually until 2020.

2.2. BULGARIA

Real GDP growth lost momentum in 2018, when Bulgaria's economy grew at an estimated rate of 3.2% compared to 3.8% in the previous year. The main driver of this slowdown was the weakening of exports due to softer external demand from large trading partners in the EU and Turkey, as well as some country-specific one-off events.

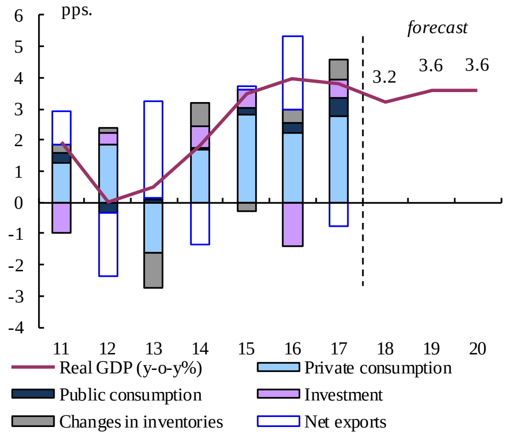
Trends in the domestic economy, by contrast, were more positive. Wage increases continued to fuel private consumption growth and the recovery in the use of EU investment funding provided a boost to investment growth. Survey data point to increasing orders and higher output, which suggests that GDP growth should recover in the coming quarters.

Domestic demand was the main engine of growth in 2018 and is expected to remain so in 2019 and 2020. Labour market tightening and additional public sector wage increases should provide continued support for private consumption in 2019. Private and public investment are also expected to remain strong, thanks to the low interest rate environment and EU funding.

Overall, real GDP growth is expected to increase to 3.6% in 2019 and remain at 3.6% in 2020. The current growth pattern suggests a relatively small impact from external shocks and exports are expected to stage a moderate recovery. Risks to the economic outlook are tilted to the downside and mainly stem from the possibility of weaker demand in major export markets.

Price pressures increased in 2018. Overall, headline inflation reached 2.6% in 2018. This is due to the rise in energy prices, while strong domestic demand and increases in unprocessed food prices, due to disappointing harvest, added to inflationary pressures. Despite the support of strong demand and high wage growth, inflation is expected to fall to 2.0% in 2019, mainly as a result of base effects, and then ease further to 1.8% in 2020.

Graph 2.2: **Bulgaria - Real GDP growth and contributions**

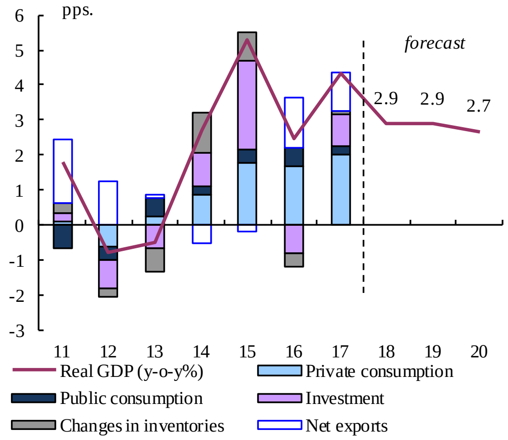


2.3. CZECHIA

The Czech economy continued to expand steadily in 2018, although somewhat more moderately than in 2017. The economy grew by an estimated 2.9% in 2018, propelled mostly by domestic demand. Investment increased considerably, especially in the first half of the year, boosted by automation needs in manufacturing and a surge in public investment supported by EU funds. Swift wage growth and record levels of employment also bolstered private consumption growth in a context of elevated consumer confidence. In view of the particularly strong rise in imports, net exports look likely to have detracted from overall economic growth in 2018.

GDP growth is expected to remain steady at 2.9% in 2019 before easing to 2.7% in 2020. Wages in both the public and private sector are likely to continue increasing at a brisk pace, providing a continued boost to private consumption. However, in view of the record-low unemployment rate in late 2018, the rate of job creation is likely to slow appreciably. Public investment growth in particular should continue to support the economic expansion, though somewhat less than in 2018 when the rate was exceptionally high. Net exports are expected to become broadly neutral for GDP growth by 2020, as both imports and exports are set to settle at somewhat more moderate — and broadly similar — growth rates over the course of 2019.

Graph 2.3: **Czechia- Real GDP growth and contributions**



The competitiveness of Czech exports risks being affected by rising real unit labour costs in 2018 and beyond due to muted productivity growth. At the same time, the combination of very low unemployment and a low ratio of job seekers per vacancy (both the lowest in the EU) could encourage businesses to invest more in machinery, which could increase productivity in the medium term.

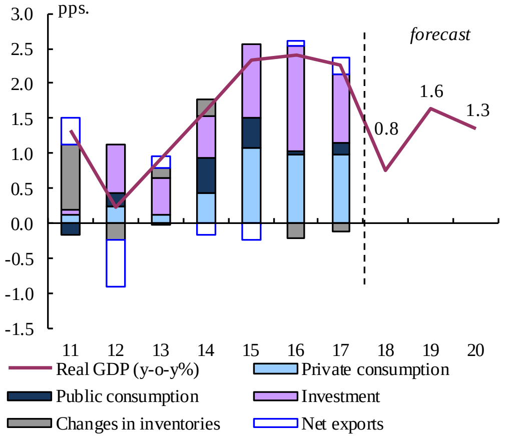
Headline inflation is expected to remain close to the 2% target of the Czech National Bank in both 2019 and 2020. The main pro-inflationary factor remains rapid wage growth, while inflationary pressures from energy are expected to subside.

2.4. DENMARK

Despite a robust expansion in 2018-Q3, real GDP is estimated to have increased only by 0.8% in 2018, the lowest rate since 2012. Last year's headline growth was negatively affected by temporary factors, including a large negative carry-over from a one-off transaction linked to the sale of a Danish patent in 2017 and weak agricultural production due to weather conditions.

Real GDP growth is forecast to increase to 1.6% in 2019, helped by a growth carry-over from 2018, but to weaken again to 1.3% in 2020. Private consumption growth is projected to remain solid in the coming years supported by the buoyant labour market, and notwithstanding the postponement from 2019 to 2020 of the reimbursement of excessively-collected property taxes to households. Rising property prices are expected to generate some impetus for residential investment, but as the number of housing permits has been declining continuously since end 2016, growth in residential construction is set to slow down. The deteriorating economic outlook in Denmark's main trading partners and frictions in world trade are expected to weigh on equipment investment and exports. Domestic demand is set to remain the main driver of growth, while net trade's contribution is expected to remain marginal.

Graph 2.4: **Denmark - Real GDP growth and contributions**



Danish consumer price inflation (HICP) slowed to 0.7% in 2018. This was mainly due to taxation changes, the decline of food prices and the muted impact of rising oil prices on Danish consumer prices. Rising service prices and the lagged increase in food prices are forecast to lift consumer price inflation to 1.2% in 2019 and to 1.7% in 2020.

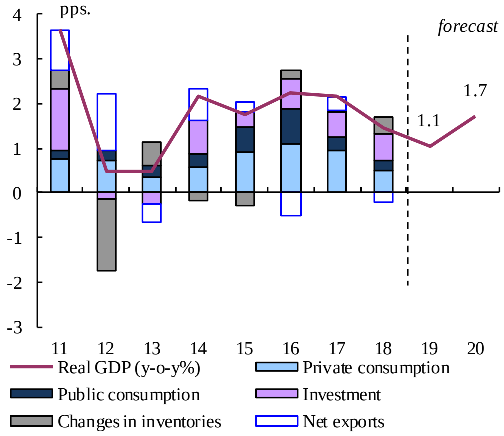
2.5. GERMANY

After averaging 2.1% over the period 2014-2017 Germany's GDP growth slowed to 1.5% in 2018. The slowdown was caused mainly by weakening export growth and growing consumer restraint, particularly in the second half of the year.

Private consumption growth disappointed despite improving labour market conditions, including higher wage growth and record high employment. The slump in private consumption in the second half of 2018 can be traced to the delays in ensuring environmental compliance of new passenger cars. Equipment investment, by contrast, grew vigourously in response to high capacity utilisation rates. The construction sector continued to boom, with confidence at an all-time high in late 2018.

With world trade and global economic growth cooling down this year and next, export growth is unlikely to soon regain the dynamism of 2014-2017. This is also likely to restrain new business investment. Indeed, high frequency indicators point to a continued deterioration in business sentiment in the manufacturing sector, with declining orders and a worsening export outlook. On the other hand, housing investment and private consumption should continue to sustain a moderate upswing helped by the positive developments on the labour market and fiscal measures boosting household incomes. Overall, real GDP growth is expected to cool further to 1.1% in 2019. In 2020, a strong calendar effect should help annual growth to rebound somewhat to 1.7%, though the quarterly dynamics would remain relatively subdued due to further moderation of demand and tightening of labour supply.

Graph 2.5: **Germany - Real GDP growth and contributions**



Downside risks are related to weaker than anticipated growth in foreign trade, muted investment, poorer business and consumer confidence, and slower or weaker take-up of the planned fiscal stimulus. On the other hand, the remarkable strength on the labour market constitutes an upside risk.

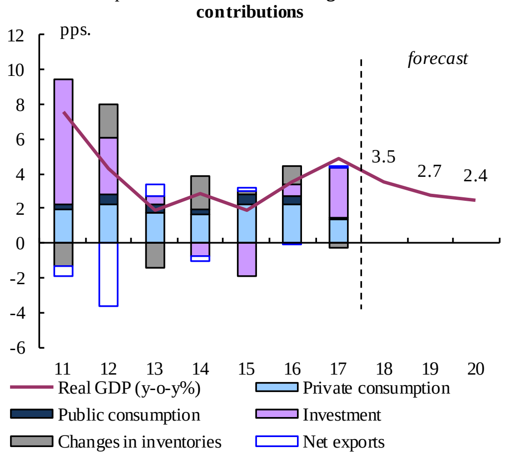
Headline inflation picked up to 1.9% in 2018 driven by energy prices, whereas core inflation remained unchanged at 1.5%. Headline inflation is expected to average around 1.5% in 2019-2020, as energy inflation moderates further. Wage growth has been strengthening but would likely moderate again if the outlook remains subdued, which should keep core inflation from rising much further.

2.6. ESTONIA

Estonia's economy is estimated to have grown by 3.5% in 2018, driven by domestic demand and wage growth. Real GDP growth displayed positive momentum throughout the year, as indicated in the most recent data.

More recently, however, consumer and business sentiment indicators have begun to trend downwards as the external outlook has weakened. As these developments seep further into domestic expectations, real GDP growth is forecast to moderate to 2.7% in 2018 and 2.4% 2020. Domestic demand is expected to remain the main growth driver, as the labour market continues to perform strongly. Also, government spending is set to grow at a relatively rapid pace in 2019. However, Estonia's small and open economy is sensitive to external conditions, suggesting downside risks to the forecast.

Graph 2.6: **Estonia - Real GDP growth and contributions**



Headline inflation has exceeded the euro area average in the past few years. Inflation reached 3.4% in 2018, largely driven by the rise in global prices for energy and food, which have a relatively high share in Estonia's consumption basket. Increases in excise duties contributed about half a percentage point to inflation in 2018. Inflation is forecast to slow to 2.8% in 2019 and 2.3% in 2020, as global commodity prices are assumed to stabilise and the effect of increased excise taxes will dissipate.

2.7. IRELAND

Ireland's domestic economy grew at a strong pace in 2018, underpinned by continued momentum in employment and investment in construction. However, headline GDP figures remained influenced by the activities of multinational companies. The strong increase in employment was spread across most sectors, supporting private consumption. Planning permissions for residential units grew strongly and construction sentiment remains high, suggesting continued momentum in construction activity in the coming quarters.

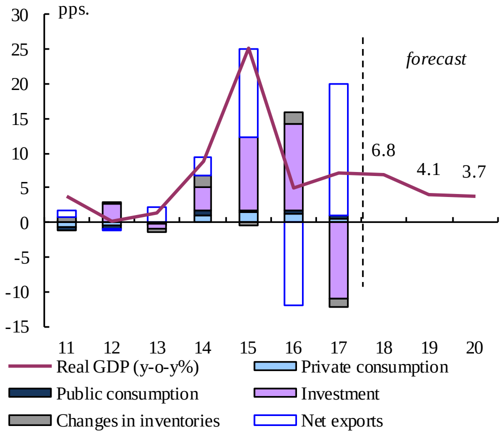
Headline trade and business investment figures remain volatile. The external economic environment has been less favourable in recent months. This is expected to slow Irish export growth over the forecast horizon.

The domestic economy is expected to expand at an average rate of 4% this year and next. Robust employment developments, stronger wage growth and weak inflation are set to further support private consumption. However, the ongoing decline in consumer confidence, reflecting uncertainty about the economic outlook, suggests downside risks to consumer spending. Construction activity is forecast to expand at a brisk pace, supported by government supply measures. Real GDP is estimated to have grown by 6.8% in 2018, well below projections in the autumn. This reflects weaker-than-expected growth in the third quarter and downward revisions to GDP statistics for the first half of the year. Influenced by the lower carry-over from 2018 and the less favourable outlook for global demand, Ireland's GDP growth is forecast to moderate to 4.1% in 2019 and 3.7% in 2020.

Consumer price inflation was low in 2018 at 0.7%. It was sustained by energy prices, while core inflation remained subdued. Headline inflation is projected to reach 0.9% in 2019. Dynamic increases in residential rents and accommodation and catering service prices should bolster service prices, whereas decreasing oil prices and the depreciation of the sterling are expected to dampen the price of goods. In 2020, headline inflation is expected to pick up to 1.4%, on the back of increasing wage pressures in a tight labour market.

The economic outlook remains clouded by uncertainty. This relates primarily to the terms of the UK's withdrawal from the EU. As a highly open economy, Ireland is also particularly exposed to changes in the international taxation and trade environment. The huge impact of the often unpredictable activities of multinationals, could drive headline growth either up or down.

Graph 2.7: **Ireland - Real GDP growth and contributions**



2.8. GREECE

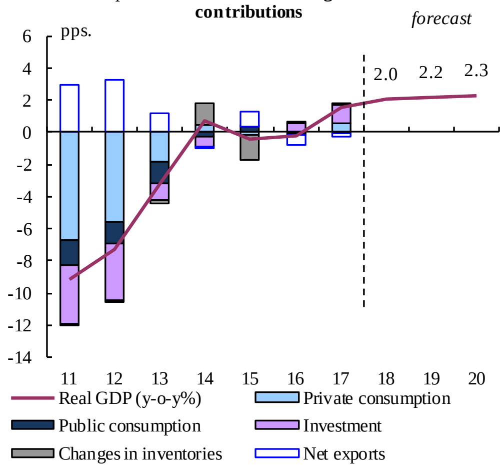
Greece's economy grew at an estimated rate of 2.0% in 2018 and is expected to continue growing at over 2% in the coming years, although the economy's recovery remains heavily contingent on the continuing implementation of reforms.

Provisional data show that Greece's real GDP grew by 1% (q-o-q, in seasonally-and working-day adjusted terms) in 2018-Q3, corresponding to growth of 2.2% compared to the same quarter in the previous year and providing a 2.1% growth rate for the first three quarters of 2018.

By taking advantage of spare capacity and benefitting from strong external demand, Greece managed to increase its market shares in global trade. Net exports thus became the main driver of growth in the first three quarters of the year, and (likely) for the whole year as well. Another major driver of aggregate demand was the growth of private consumption, which was supported by employment growth. Investment remained subdued compared to 2017, at least in part due to a base effect from the revision of the annual national accounts. On a positive note, activity in the real estate sector and hence investment in housing grew throughout the year.

Real GDP growth is forecast to reach 2.2% in 2019 and 2.3% in 2020. Consumer confidence had almost returned to pre-crisis heights by the end of 2018, thus private consumption is likely to remain a major contributor to growth in 2019. Export growth is expected to moderate, as the tourism sector faces slowing demand growth and renewed competition from Turkey. Goods exports are also set to weaken but should remain on an increasing trajectory despite the slowdown in the EU.

Graph 2.8: **Greece - Real GDP growth and contributions**



The labour market has been improving steadily with unemployment falling to 18.6% in October 2018, down from 21% a year earlier. Full-time and dependent employment growth remains the main driver of employment gains, while part-time employment and self-employment growth remains subdued. The national accounts suggest that employment rose by 1.5% in the first three quarters of the year, which indicates improvements in labour productivity.

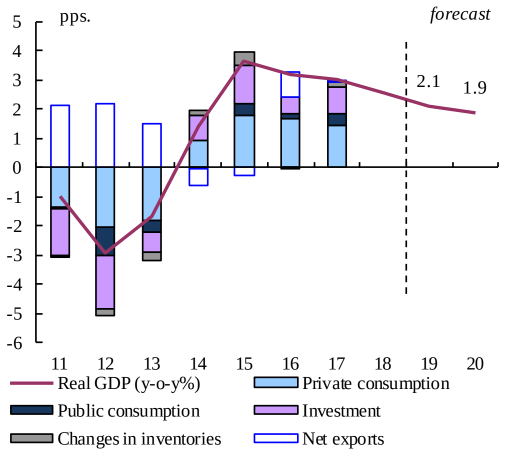
Headline inflation reached 0.8% in 2018 and is forecast to remain moderate in 2019 on the back of subdued energy prices, before increasing in 2020 as core inflation rises.

2.9. SPAIN

The expected mild deceleration of real GDP growth materialised in the first three quarters of 2018. In the last quarter, real GDP growth regained some momentum and expanded by a robust 0.7%, partly due to a rebound in net exports. Still, for the whole of last year, net exports detracted 0.4 pps. from growth, while domestic demand kept growing robustly. As a result, real GDP in 2018 grew by 2.5%, 0.5 pps. less than in 2017, and 0.1 pps. lower than projected in the autumn forecast.

Growth is expected to decelerate further to 2.1% in 2019 and 1.9% in 2020 (also 0.1 pps. lower than in the autumn forecast for both years), as the cycle matures. The deceleration is mainly driven by a slowdown in private consumption, which is expected to grow more slowly than disposable income, as pent-up demand is absorbed and households increase their saving rate. The latter is projected to rebound in 2019 from the historic low recorded in 2018 and increase slightly further in 2020. Job creation is forecast to ease, also due to the expected dampening impact of the increase in the minimum wage. Still, employment growth is set to allow for further reductions in the unemployment rate. Investment in both equipment and construction is also expected to decelerate in line with final demand, after buoyant growth in recent years.

Graph 2.9: **Spain - Real GDP growth and contributions**



The contribution of the external sector to growth is projected to remain negative but improve in 2019, and turn neutral in 2020. Despite weak growth in global trade, exports are forecast to accelerate slightly in 2019 and 2020, as Spain's export market shares gradually improve after a sharp deterioration in 2018. At the same time, imports are expected to decelerate broadly in line with final demand.

Risks to the forecast relate mainly to a weaker than expected global environment and increased uncertainty, both domestic and external.

Headline inflation reached 1.7% in 2018 and is forecast to decline to 1.2% in 2019 due to base effects from oil price developments. It is then set to increase to 1.5% in 2020, as core inflation gradually picks up. Wage growth is expected to accelerate in 2019, partly under the impact of the increase in the minimum wage, and to moderate but still be above inflation in 2020.

2.10. FRANCE

Quarterly GDP growth reached 0.3% both in the third and fourth quarter of 2018. As a result, annual GDP growth decreased to 1.5% in 2018 from 2.2% in 2017 ([19]). After a weak start to the year, economic activity accelerated during the summer, although slightly less than expected. In addition, at the end of the year, social protests affected GDP growth. In this context, private consumption stagnated in the fourth quarter in contrast to what was expected in the autumn forecast and despite several fiscal measures favourable to purchasing power that had already been enacted before the social unrest. Investment remained dynamic overall, although less buoyant than in 2017. Import growth decreased sharply in 2018, while exports remained robust, though somewhat less so than in 2017.

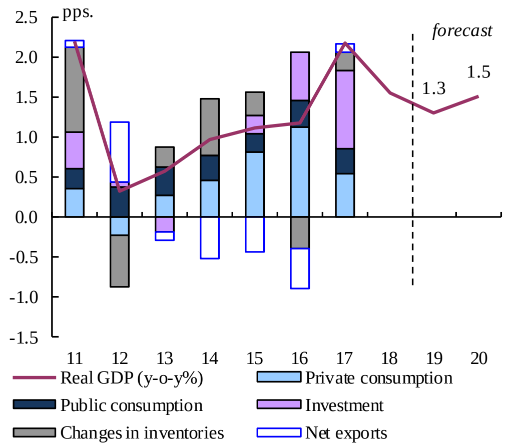
Quarterly GDP growth is set to increase somewhat in the near future. Private consumption is expected to rebound in the first quarter of 2019 and to recover more gradually thereafter. Fiscal measures, including those additionally adopted at the end of 2018, as well as lower inflation, should provide support to purchasing power. The overall effect on private consumption could nevertheless be limited in the first few months, translating instead into precautionary savings, in line with the persistence of low consumer confidence levels. Investment growth is set to ease but should remain stronger than GDP growth, as suggested by economic sentiment indicators. The growth contribution of net exports is projected to disappear. Imports are set to accelerate, boosted by domestic demand, while exports are set to moderate slightly in line with slower world trade. As a result, GDP growth is expected to reach 1.3% in 2019 and 1.5% in 2020.

([19]) The GDP growth figures are non-calendar adjusted. Calendar adjusted GDP growth reached 2.3% in 2017 and should reach 1.4% in 2020. Calendar effects are not significant in 2018 and 2019.

Risks to this scenario are slightly tilted to the downside. In addition to general risks, the persistent weakness of consumer confidence could translate into lower-than-projected private consumption growth. On the other hand, the impact of the measures announced by the government at the end of 2018 could materialise faster than expected.

Inflation picked up in 2018 and reached 2.1%, sustained by higher oil prices and increases in tobacco excises and energy taxes. It is expected to fall back to 1.4% in 2019 as oil prices and taxes abate before reaching 1.7% in 2020, partly sustained by core inflation. Core inflation is projected to gain momentum in line with slightly higher wage growth but should remain contained.

Graph 2.10: **France - Real GDP growth and contributions**

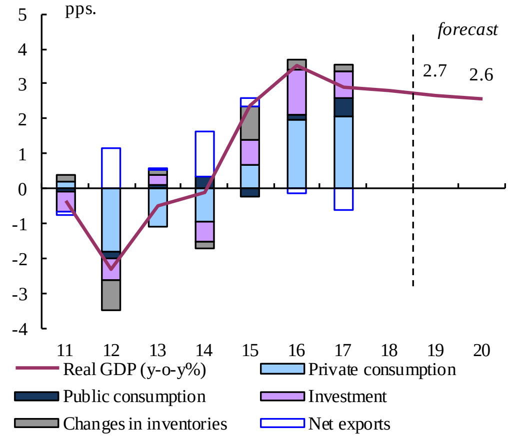


2.11. CROATIA

Croatia's economy likely grew at a broadly steady pace in 2018, with real GDP growth for the year estimated at 2.8%, only slightly lower than in 2017. As exports slowed somewhat, particularly to non-EU neighbouring countries in the second half of the year, growth was increasingly driven by private consumption.

As suggested by high-frequency data on retail trade at the turn of the year, private consumption is expected to remain the main driver of growth, supported by improving labour market conditions, positive consumer sentiment, low interest rates and subdued inflation. Administrative data at end-2018 suggest that dynamic employment growth continues to drive a steady fall in the unemployment rate. Private investment is expected to continue its modest growth, as companies continue to enjoy favourable financing conditions. The projected pick-up in disbursements from EU funds should provide a boost to public investment, which will nevertheless stay well below pre-recession levels. Overall, real GDP growth is forecast to continue moderating to 2.7% in 2019, and further to 2.6% in 2020.

Graph 2.11: **Croatia - Real GDP growth and contributions**



In view of the anticipated slowdown in Croatia's main trading partners in the EU, goods exports are likely to grow more slowly than in recent years. Service exports are expected to continue performing well on account of an increasingly extended tourist season and sizeable investment in higher-end hotels in recent years. Bolstered by high domestic demand, imports of goods are set to remain strong, slowing only slightly over the forecast horizon and driving the goods trade balance increasingly negative.

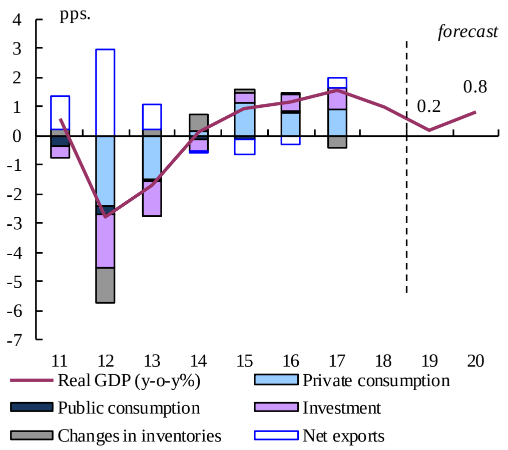
Inflation has remained relatively low despite higher disposable income and recent spikes in energy prices. Wage pressures are expected to strengthen as unemployment continues to shrink further. However, inflationary pressures are projected to remain subdued thanks to the VAT rate reduction on several unprocessed food products this, and the 1 pp. reduction of the standard VAT rate next year, as well as stabilising commodity prices. In all, headline inflation is forecast at 1.4% in both 2019 and 2020.

2.12. ITALY

Italy's economy started losing momentum in early 2018 amid a wider slowdown of the euro area and slipped into a contraction in the second half of the year. Real GDP fell by 0.2% in the last three months of 2018, following a 0.1% drop in the previous quarter. While the initial slowdown was largely due to less dynamic world trade, the recent slackening of economic activity is more attributable to sluggish domestic demand, particularly investment, as uncertainty related to the government's policy stance and rising financing costs took its toll. In annual terms, real GDP grew by 1.0% in 2018, helped by a sizable carry-over effect from the previous year. The ongoing weakening in the manufacturing sector with a further decline in economic sentiment bodes ill for the near-term outlook. Economic activity is likely to remain anaemic in the first half of 2019.

In 2019, annual real GDP growth is forecast to fall to 0.2%, sizeably less than anticipated in the autumn forecast. A worse-than-expected cyclical slowdown in 2018, amplified by global and domestic policy uncertainty and firms' substantially less favourable investment outlook, largely explain this downward revision. Moreover, the more marked slowdown of important trade partners is likely to have knock-on effects on Italian manufacturing output. Following the budget revision in December 2018, sovereign yields eased, but are still significantly higher than a year ago. In 2020, growth is expected to pick up to 0.8%, helped by a positive carry-over effect and two more working days in 2020. The forecast does not incorporate the effects of the rise in indirect taxes envisaged in the 2019 budget for 2020.

Graph 2.12: **Italy - Real GDP growth and contributions**



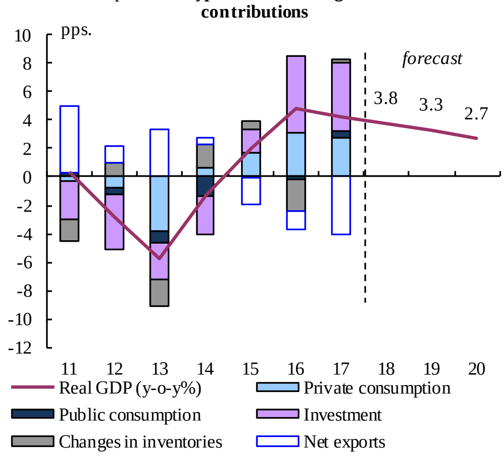
Private consumption is set to underpin GDP growth, helped by a rise in real disposable income due to lower oil prices and marginally supported by the introduction of the citizenship income scheme, but partly dampened by a deteriorating employment outlook. By contrast, business investment is expected to decelerate sharply in 2019 and remain muted in 2020. Following the setback recorded in the first half of 2018, exports recovered and are estimated to expand at a pace closer to that of foreign demand over the forecast period. As slowing investment is set to soften import growth, net exports are likely to provide marginal support to GDP growth. The growth outlook is subject to high uncertainty. A weaker-than-expected global economy and the impact of heightened policy uncertainty on sentiment and financing conditions of the private sector could lead to a more protracted downturn.

Headline inflation is forecast to moderate in 2019 on the back of lower energy prices. Consumer prices increased by 1.2% in 2018 but are expected to rise by only 1.0% this year, before picking up again to 1.3% in 2020. Core inflation is set to rise gradually over the forecast period, in line with wage growth.

2.13. CYPRUS

Cyprus' economy grew strongly in the first three quarters of 2018, although real GDP growth in the third quarter (3.7% y-o-y) was the lowest of the year. Economic sentiment rebounded in the fourth quarter after a soft patch in the second and third. For the year as a whole, real GDP growth is expected to reach 3.8%, following 4.2% in 2017.

Graph 2.13: **Cyprus - Real GDP growth and contributions**



The labour market continues to perform strongly. Employment increased by 3.7% (y-o-y) in 2018-Q3 and compensation per employee by 1.9% (compared to 0.7% in 2017). Despite rising household income, consumer confidence dipped, influenced by the sale and winding down of the

Cyprus Cooperative Bank. The bank was the second largest in the country and held many household and SMEs deposits. Survey data signalled that the construction sector continued hiring in the fourth quarter.

Going forward, employment gains and higher wages are expected to boost disposable income and to support private consumption. Public consumption is also expected to grow amid rising wages and employment in the public sector. Investment should make a positive contribution in 2019 on the back of strong construction activity. In 2019 and 2020, growth is projected to slow down to 3.3% and 2.7%, due to the less favourable external environment. Slowing growth in the euro area and persistent uncertainties in major trading partners weigh on Cyprus' outlook and increase downside risks.

Inflationary pressures remain very weak. Consumer price inflation stood at 0.8% in 2018, only marginally higher than a year before. Inflation accelerated in the second half of the year, driven by energy and unprocessed food prices. Core inflation throughout 2018 fluctuated around zero, as moderately higher prices of services were offset by falling prices of non-energy industrial goods. Over the coming quarters, two opposing forces will be at play: rising disposable income, which will fuel price pressures; and lower oil prices, which will dampen them. Overall, headline inflation is expected to ease to 0.7% in 2019. As the impact of lower oil prices fades, inflation should pick up moderately in 2020 to 1.2%.

2.14. LATVIA

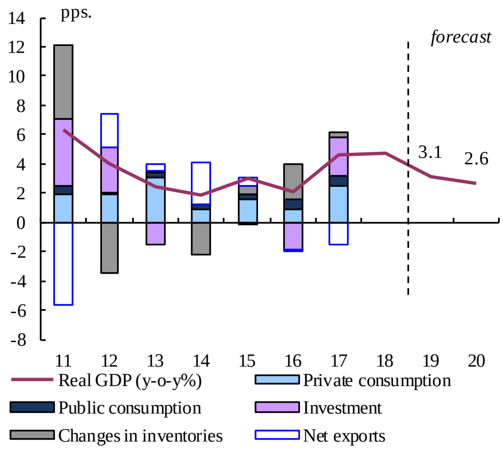
Continued rapid investment growth coupled with persistently strong private consumption are expected to have pushed GDP growth in Latvia to 4.7% in 2018. However, export growth slowed, mostly due to weaker agricultural and food exports as a result of a poor harvest, but also because of a decline in road transport and financial services. Unemployment fell even faster than in 2017 as the investment boom helped increase employment notably for the first time in three years. Although this supported continued rapid wage growth, headline inflation slowed to 2.6%, largely due to lower growth in food prices.

GDP growth is forecast to slow in 2019 as investment growth moderates. However, brisk private consumption growth is expected to extend into 2019 supported by still rapid wage growth.

However, with external demand weakening and both financial and transport services expected to continue struggling, export growth in 2019 is set to be modest. Public consumption growth is expected to be constrained, due to a lack of fiscal space. On the back of these factors, GDP growth in 2019 is forecast to cool to 3.1%. Growth is forecast to fall further in 2020 to 2.6%, as slower growth in the rest of the EU will eventually weigh on consumer optimism and private consumption, which have been the backbone of GDP growth over the last three years. Delayed energy price increases and a recovery of unprocessed food price inflation are expected cause inflation to rise slightly in 2019 before falling again in 2020. Slowing investment growth should ease pressure on the labour market but the market it is set to remain tight, as the labour force continues to decline. Wage growth is expected to remain steady.

Risks to the forecast are tilted to the downside as a deterioration of the external environment could lead to a sharper slowdown than currently forecast.

Graph 2.14: **Latvia - Real GDP growth and contributions**



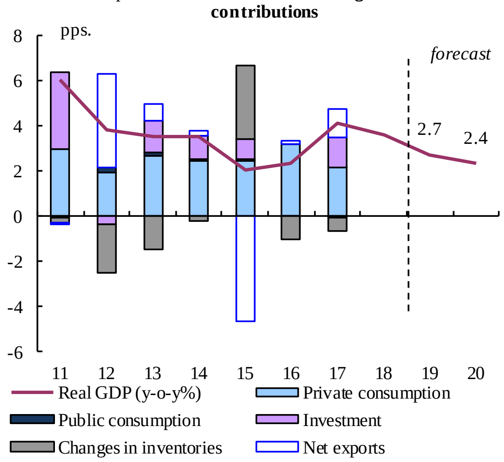
2.15. LITHUANIA

Following its peak in 2017, Lithuania's real GDP growth rate was estimated at 3.6% in 2018, with growth accelerating in 2018-Q4 (+1.6%, q-o-q). Overall, growth in 2018 was broad-based across all sectors, with the exception of agriculture, and benefitted from increases in wholesale and retail trade, construction, as well as industrial production, especially of capital and intermediate goods.

The strong growth momentum is expected to continue in 2019, as consumer confidence and industrial sentiment indicators remain high. Income tax cuts are set to provide a positive impetus to consumption over the forecast horizon. At the same time, economic growth is forecast to benefit from the continuing support of EU investment funding. Lithuania's economy, however, will not be able to completely escape the impact of weaker growth in its main trading partners. Therefore, GDP growth is forecast to moderate to 2.7% in 2019 and 2.4% in 2020.

Headline inflation dropped from 3.7% in 2017 to 2.5% in 2018. Strong wage growth coupled with higher oil prices were the main inflation drivers in 2018. In 2019, a notable increase in gas and electricity prices for households is set to exert upward pressure on inflation. However, moderating oil prices should have a dampening effect. Overall, prices are expected to moderate further in 2019 and 2020 to 2.2% and 2.1%, respectively.

Graph 2.15: **Lithuania - Real GDP growth and contributions**

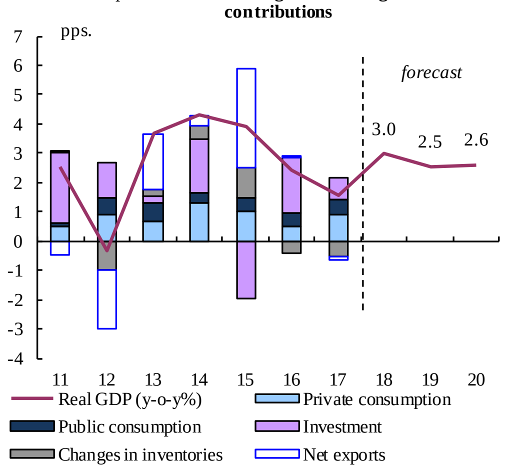


2.16. LUXEMBOURG

After slowing to 1.5% in 2017, GDP growth in Luxembourg regained momentum, and is estimated to have reached 3.0% in 2018. Notably, the international services balance showed a sizeable expansion, largely related to renewed dynamism in the financial services sector, which had been exceptionally weak in 2017. However, historical figures need to be taken with caution given the frequent and substantial revisions to Luxembourg's national accounts data. Private consumption growth also strengthened in 2018, benefitting from the improvement in the labour market, including stronger resident employment creation, while disposable income received a boost from tax reforms and increases in wages, salaries and pensions due to a wage indexation applied from August.

The recent softening growth momentum in world trade, as well as in euro area GDP growth, has contributed to higher volatility in financial markets. A broad set of indicators suggesting that these trends may continue in 2019 has weakened growth prospects for the financial services sector and the economy as a whole. Therefore, external trade is expected to weaken markedly. As a small open economy with strong trading and financial links in international markets, Luxembourg remains especially exposed to external risks surrounding the euro area outlook. At the current juncture, uncertainty has increased and risks remain tilted to the downside.

Graph 2.16: **Luxembourg - Real GDP growth and contributions**



Domestic demand is forecast to be the main growth driver going forward. However, private consumption growth is projected to lose some momentum as employment growth slows. Private investment, by contrast, should recover after a drop in 2018 mainly driven by past effects; specifically, from bulk investments in 2017 by the aircraft and satellites industry (which were also fully debited from the external balance of goods). Overall, despite supportive domestic demand, GDP growth is forecast to ease to 2.5% in 2019 before perking up again slightly to 2.6% in 2020. While the underlying conditions for private consumption and investment remain favourable, further weakness due to waning consumer confidence, could raise precautionary savings and result in lower domestic demand growth.

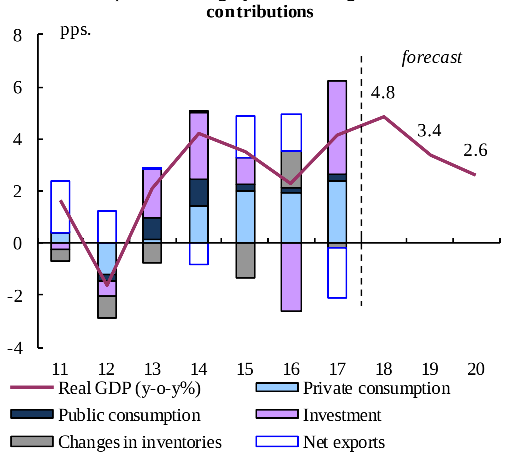
Headline inflation eased slightly to 2.0% in 2018 from 2.1% in 2017, mainly due to oil price movements. Oil prices are assumed to ease significantly in 2019, which should drive down headline inflation to 1.6%, although this effect will gradually dissipate in 2020. At the same time, domestic price pressures, including from past wage increases, are set to reassert their influence and headline inflation should increase from 1.6% in 2019 to 1.8% in 2020.

2.17. HUNGARY

The strong cyclical pickup of domestic demand allowed Hungary to defy the international economic slowdown in 2018. GDP growth is expected to have accelerated from 4.1% in 2017 to almost 5% in 2018. Nonetheless, the domestic cycle has reached its peak, while export growth remains modest. Economic growth is set to slow to 3.4% in 2019 and further to 2.6% in 2020.

Investment has grown rapidly in every sector, bolstered by high capacity utilisation rates, the recovery of the housing market and pro-cyclical fiscal expansion. It is forecast to stabilise at a high level relative to GDP in the coming years as the absorption of EU funds peaks and a temporary value added tax cut on new housing expires.

Graph 2.17: **Hungary - Real GDP growth and contributions**



Private consumption growth is supported by the robust labour market, high confidence and easing credit conditions. Employment has risen to new records, while labour shortages and minimum wage increases continue to lift real wages. As the economy absorbs its labour reserves, employment and income growth are set to slow, moderating consumption dynamics.

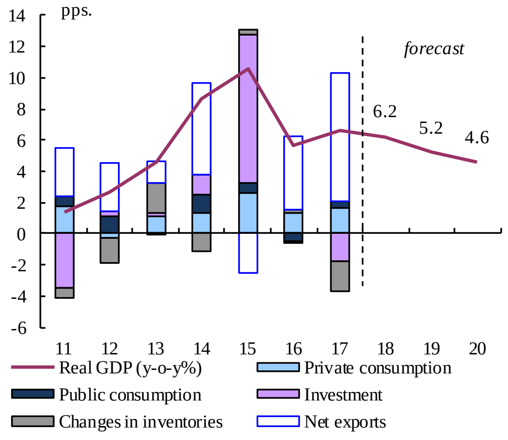
External factors counterbalance growing domestic inflationary pressure. Strong demand and labour cost growth is fuelling core inflation, but subdued oil prices are expected to keep headline inflation near 3% in 2019 and 2020.

2.18. MALTA

Malta's economy maintained a strong growth trajectory in 2018, with a particularly brisk expansion in the third quarter. Real GDP growth is estimated to have reached 6.2% in 2018, making Malta one of the most dynamic economies in the EU.

Starting from the second quarter of 2018, domestic demand replaced net exports as the main driver of growth. Private consumption has been buoyant, reflecting strong employment growth, increasing disposable income and a large accumulation of savings in recent years. Investment remained subdued in the first three quarters of 2018, especially in non-residential construction and transport. Export growth slowed down from the high rates registered in recent years due to a weaker external environment and a drop in goods exports, while imports have started to recover, supported by strong domestic demand.

Graph 2.18: **Malta - Real GDP growth and contributions**



Growth is expected to continue over the forecast horizon, albeit at a slower pace. In 2019 and 2020, real GDP growth is set to ease to 5.2% and 4.6%, respectively. As global demand moderates, economic growth is expected to continue relying on domestic demand, underpinned by high private and public consumption. Investment growth is expected to pick up on the back of large-scale infrastructure projects in the health, tourism and real estate sectors. The current account surplus is projected to remain large, reflecting the significant trade surplus of the internationally-oriented services sector.

Consumer price inflation began to accelerate in the second quarter of 2018 and reached 1.7% by the end of the year. In part, the acceleration reflects the statistical impact of the increase in the weight of accommodation services in the price index basket for 2018. Despite tighter labour market conditions, wage pressures have yet to fully materialise. As wage growth starts gaining pace, inflation should gradually rise to 1.9% in 2020.

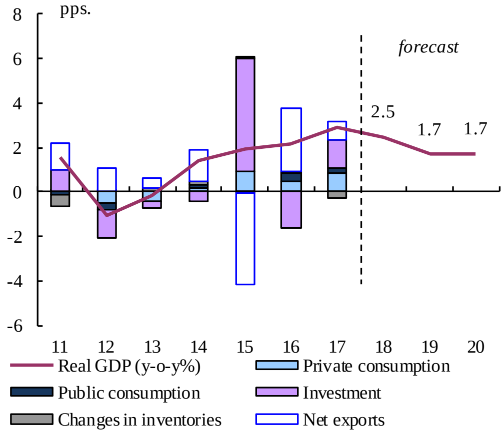
2.19. THE NETHERLANDS

After a solid first half of the year, growth fell back in the third quarter of 2018 amid a wider slowdown across the euro area. For 2018 as a whole, growth is estimated at 2.5%. The economic expansion is set to continue over the forecast horizon but at a slower pace than in previous years. GDP is projected to grow by 1.7% in both 2019 and 2020, driven mainly by domestic demand.

Solid employment growth and rising wages are set to boost disposable income and thereby support private consumption. At the same time, the relatively sharp fall in consumer sentiment in recent months is expected to be a drag on spending decisions. Corporate investment growth is expected to decline, in line with the slower economic expansion overall and increased international uncertainty. Residential investment growth is also set to moderate as new construction planning is stagnating and the number of housing transactions is declining. The fiscal stimulus is projected to be supportive to growth in 2019, with higher expenditure focused on education, defence and infrastructure. However, observed underspending in 2018 combined with supply constraints in the economy point to implementation risks. The growth contribution of net exports is expected to be close to zero as a result of the weaker external environment.

Headline inflation is projected to rise from 1.6% in 2018 to 2.4% in 2019, largely driven by an increase in the reduced VAT tariff from 6% to 9%. Gradually increasing wages are also set to exert upward pressure on the price level. Higher energy prices pushed up inflation in recent months, but their influence is expected to dissipate in line with lower oil prices compared to the second half of 2018. In 2020, inflation is forecast to fall back to 1.7%.

Graph 2.19: **The Netherlands - Real GDP growth and contributions**



2.20. AUSTRIA

After a strong first quarter in 2018, Austria's GDP growth decreased markedly in the second quarter. It remained at low although solid levels in the second half of 2018, leading to 2.7% growth for the year as a whole. Growth has been driven by private consumption and investment, as well as a positive contribution from net exports. While still above their long-term averages, economic sentiment indicators have fallen over the year, adding further weight to the likelihood that economic growth is set to slow gradually. GDP is forecast to grow at 1.6% in both 2019 and 2020.

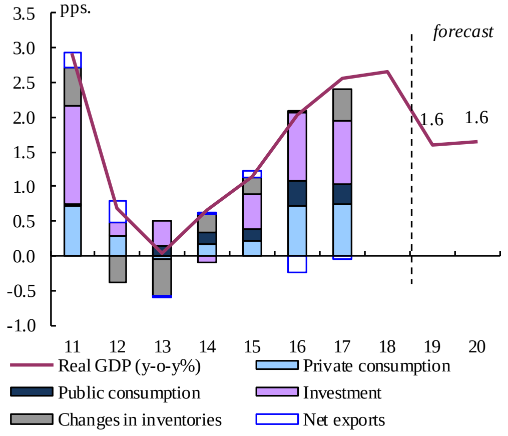
Investment growth is set to remain firm over the forecast horizon, but to moderate from high levels. It is expected to be supported by full construction order books thanks to economic and population growth. After rising strongly for three years in a row, equipment investment is set to grow more moderately, in line with lower economic growth. Boosted by employment growth and solid wage increases, as well as the tax relief provided by the new 'Family Bonus plus', private consumption is set to become the main contributor to growth.

In 2018, export growth remained firm, while import growth declined. In 2019 and 2020, foreign trade is set to be less dynamic, in line with the slowdown in Austria's main trading partners.

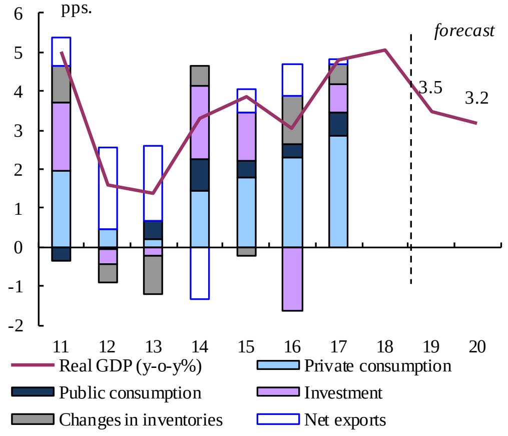
In 2018, the rise in oil prices kept headline inflation above 2%, while core inflation decreased to 1.9%. In 2019 and 2020, increasing wages and strong domestic demand are expected to put pressure on domestic prices, with headline inflation stabilising at 2%, while core inflation is set to increase to 2.1% in both years.

observed in most categories of goods and services with fast wage growth projected to have a particularly strong impact on service prices.

Graph 2.20: **Austria - Real GDP growth and contributions**



Graph 2.21: **Poland - Real GDP growth and contributions**



2.21. POLAND

Poland's GDP growth reached 5.1% in 2018, the fastest growth rate since 2007. Growth was mainly driven by domestic demand, especially strong private consumption, public investment, and a sizeable build-up of inventories. Economic sentiment indicators weakened in the last months of 2018 and in January 2019, but they remain above their long-term averages.

Public investment growth is expected to remain strong in 2019 with the support of EU funds. High capacity utilisation is set to be an important factor strengthening private investment, especially machinery and equipment investment. Fast wage growth should support private consumption, but slowing employment and higher inflation are set to have the opposite effect. As a result, consumption growth is expected to moderate compared to 2018. The dynamics of both exports and imports are set to slow from 2018 levels given weaker external demand. Overall, real GDP growth is expected to gradually slow to 3.5% in 2019 and 3.2% in 2020. Risks to this outlook are broadly balanced and mainly related to external demand and private investment trends.

Inflation, and especially the dynamics of energy and service prices, decreased at the end of 2018. Inflation is expected to average 2.3% in 2019 before increasing to 2.7% in 2020. The administrative freeze on household electricity prices is assumed to remain in place in 2019. The gradual rise in annual inflation is expected to be

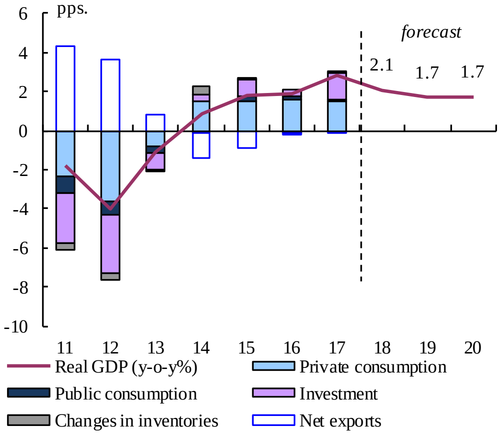
2.22. PORTUGAL

Portugal's GDP growth moderated to 2.1% (y-o-y) in the third quarter of 2018, influenced by less dynamic external demand. Despite some slowdown, private consumption growth remained strong, supported by sustained job creation and moderate wage growth. Investment also performed strongly, driven by equipment purchases. At the same time, export growth slowed substantially, albeit from a high base, reflecting weaker demand from trading partners and production halts in some industrial sectors. The Commission's Economic Sentiment Indicator (ESI) rebounded towards the end of 2018 and dropped marginally at the beginning of 2019 showing a mixed picture across sectors. The main weakness appears in the industrial sector while sentiment in services and retail trade are still improving.

The economic expansion is expected to moderate further due mainly to a weaker contribution from net exports. Growth in private consumption is set to decrease only marginally while investment is forecast to accelerate slightly, supported by increased absorption of EU funds. Overall, GDP growth is estimated at 2.1% in 2018 and is forecast to stabilise at 1.7% in both 2019 and 2020 amid a slowdown in exports of goods and services. Risks to the outlook appear on the downside, as the projected deterioration in external demand and increased global uncertainty could have negative repercussions on business investment decisions.

Inflation averaged 1.2% in 2018 amid significant volatility throughout the year. The rate peaked to 1.8% (y-o-y) in the third quarter of 2018 but dropped abruptly to 0.8% in the last quarter due mainly to downward corrections in the prices of energy and tourist accommodation. As domestic demand continues to benefit from favourable labour market conditions, inflation is projected to increase slightly to 1.3% in 2019 and 1.6% in 2020. Accordingly, core inflation is set to move marginally above the headline rate, supported by a pick-up in wage growth. The recent recovery in residential construction expectedly contributed to some moderation in house price inflation to 8.5% (y-o-y) in the third quarter of 2018 after a peak of 12.2% early in the year. House prices are expected to moderate further over the forecast period reflecting a gradual recovery in supply along with some slowdown in external demand.

Graph 2.22: **Portugal - Real GDP growth and contributions**



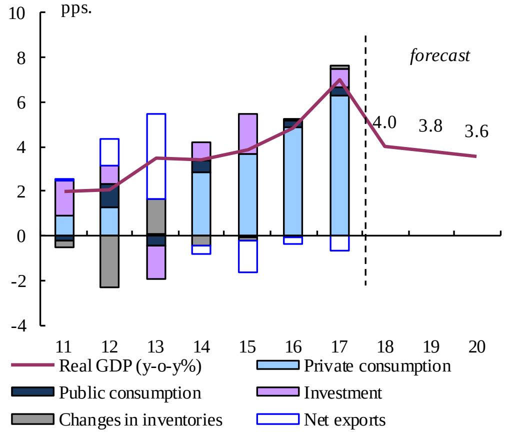
2.23. ROMANIA

The economic boom that began in Romania in 2017 eased in 2018. Real GDP growth eased from 7 % in 2017 to 4.3% annualised in the first three quarters of 2018. For the year as a whole it is estimated at 4 %. The slower pace of growth was due to private consumption, as the effects of tax cuts implemented in 2017 faded away and inflation weighed more heavily on real disposable income. Nonetheless, private consumption growth remained strong as a result of the tight labour market and rising wages.

Investment growth is likely to show a significant decrease in 2018, following contractions in the second and third quarters. According to preliminary data, inventories contributed 2.8 pps. to GDP growth in the first half of 2018. If confirmed, this build-up of inventories may explain the subdued level of private investment in 2018. Net exports contribution to GDP growth turned more negative in 2018, with both imports and exports declining. Consumption goods were the main drivers of import developments. Exports decelerated on the back of more sluggish external demand and an appreciation of the real effective exchange rate.

Real GDP growth is forecast to further decrease to 3.8 % in 2019 and 3.6 % in 2020. The composition of growth is expected to remain fairly stable, with private consumption still the main driver. The evolution of investment in 2019 will largely depend on the impact of policies introduced in December 2018 concerning the banking, energy and telecommunications sectors. The contribution of net exports is expected to remain negative but progressively less so in 2019 and 2020.

Graph 2.23: **Romania - Real GDP growth and contributions**



The annual headline inflation, reached 4.5% in September 2018, the highest level since 2013, and averaged 4.1% in 2018 overall. The deceleration towards the end of 2018 was mainly on account of decreasing food and, above all, energy prices. Over the forecast horizon, headline inflation is forecast to decelerate further to 3.3% in 2019 and 3.1% in 2020, driven by base effects and falling oil prices. However, a further depreciation of the currency vis-à-vis the euro poses an upward risk to price levels. Underlying inflation remained broadly stable in 2018, growing at 2.7% but it is expected to decrease further in 2019 and 2020, in line with headline inflation.

Risks to the forecast are clearly on the downside. Besides a potential negative impact on credit, the impact of the government's emergency ordinance in December could have a much broader effect.

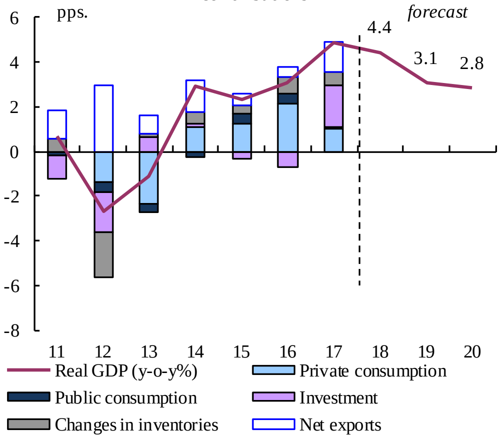
For example, significantly increased unpredictability of the business environment in Romania may have a negative knock-on effect on investment decisions.

2.24. SLOVENIA

Slovenia's economic growth is estimated to have reached 4.4% in 2018, compared to 4.9% in 2017. Growth was broad-based, driven by both strong investment dynamics and consumer spending, as well as net exports. Economic sentiment remains above its long-term average. Although it worsened over the course of 2018, it improved somewhat in the final months of the year. Job creation remained steady and unemployment further declined to 5% in the third quarter – reaching a level last seen in 2008.

With strong employment and continued wage growth, consumption is set to strengthen over 2019 and 2020. Business investment activity also is expected to remain buoyant amid favourable financing conditions, high levels of capacity utilisation and supply constraints appearing in some sectors. Furthermore, elevated construction confidence, together with rising house prices are expected to lead to an increase in housing supply. Commercial real estate is also expected to remain strong. Public investment is projected to continue growing, driven also by EU funding.

Graph 2.24: **Slovenia - Real GDP growth and contributions**



Net exports' contribution to growth is expected to turn negative over the forecast horizon, amid slower growth in export markets and sustained domestic demand growth. Overall, GDP growth in 2019 is forecast to reach 3.1% and to ease to 2.8% in 2020.

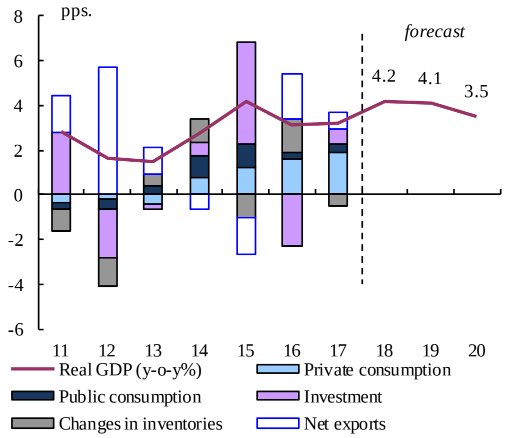
Inflation slowed somewhat at the end of 2018, with headline inflation reaching an average rate of 1.9% for the year - up from 1.6% in 2017. Due to the assumed fall in fuel prices, energy prices are expected to have a lower impact on inflation than in recent years, while higher wage increases are expected to have a stronger impact on service prices. Overall, consumer price inflation is forecast to average 1.9% in 2019 and 2.1% in 2020.

2.25. SLOVAKIA

Slovakia's economic growth is estimated to have strengthened to 4.2% in 2018 from 3.2% in 2017, driven mainly by domestic demand. Private consumption is expected to have eased slightly in 2018, contrasting with robust investment growth last year, particularly in the first two quarters. Private consumption is set to remain a robust contributor to economic growth. Indeed, consumer confidence remains at post-crisis record levels, underpinned by swift wage growth and a solid economic outlook.

Despite rising concerns about global trade prospects, net foreign demand is expected to stimulate economic growth markedly in 2019, not least due to rising production volumes in the export-oriented automotive sector. These are likely to more than offset the anticipated moderation in global trade flows.

Graph 2.25: **Slovakia - Real GDP growth and contributions**



Investment growth is likely to slow somewhat from 2019 onwards as capacity-building in the automotive sector comes to an end. While public investment — partly funded by the EU — is likely to shore up overall investment activity, a significant increase in the pace of EU funds absorption is unlikely to occur during the forecast horizon. Overall, real GDP growth is projected to remain strong at 4.1% in 2019 before declining to 3.5% in 2020.

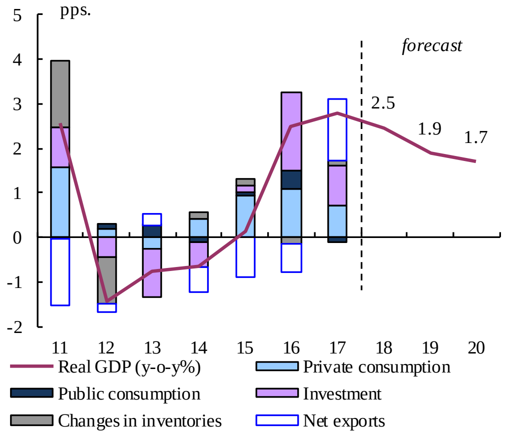
Falling unemployment in 2018 has fuelled labour shortages and put upward pressure on wages. Backed by rapid job creation, rising earnings are bolstering household budgets and are likely to allow private consumption to maintain its momentum in 2019 and 2020.

Consumer price inflation reached 2.5% in 2018, with all components contributing positively. In line with the tight labour market and rising wages, service price inflation picked up in 2018 and is set to play a major role in maintaining a consumer price inflation rate of around 2.5% in 2019 and 2020.

2.26. FINLAND

After a strong start in the first quarter of 2018, Finland's GDP growth slowed somewhat in subsequent quarters. Most high-frequency indicators suggest that growth will continue to decline gradually in the coming quarters.

Graph 2.26: **Finland - Real GDP growth and contributions**



However, Finland's economy is still growing at above-potential rates, labour market conditions continue to improve and household disposable income continue to rise. These positive trends should boost private consumption, which is set to become the major growth driver. Investment also is expected to continue growing, supported by favourable financing conditions and high capacity utilisation, but its pace is expected to slow due to capacity constraints in the construction sector. The positive contribution from external trade to growth is set to diminish as domestic demand strengthens, fuelling imports. Real GDP growth for this year is forecast to cool to 1.9% from an estimated 2.5% in 2018. In 2020, growth is expected to slow down further to 1.7%, converging towards the long-term potential growth rate of the economy.

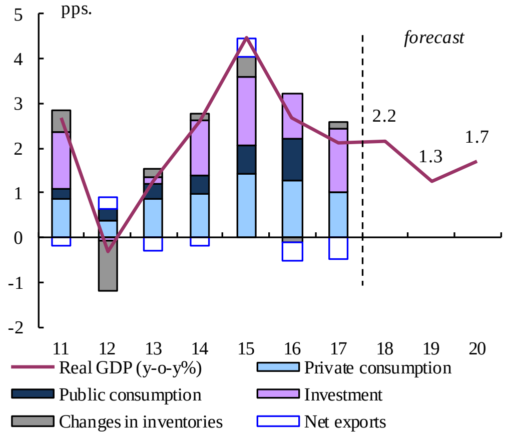
Risks to the outlook are tilted to the downside and are predominantly related to external factors. Demand growth in Finland's main trading partners could prove even weaker than expected, which would harm growth and business investment decisions.

On the back of the rise in energy and food prices, inflation accelerated somewhat in 2018, but remained among the lowest in the EU. Further moderate acceleration in inflation is expected in both 2019 (1.4%) and 2020 (1.8%) due to rising wage pressures, which in turn may lead to higher service prices.

2.27. SWEDEN

Sweden's economy remained strong in 2018, with real GDP growth estimated at 2.2%, driven by solid domestic demand. Gains in household income and consumption expenditure were underpinned by rising employment while the lagged effects of a weaker effective exchange rate supported exporting industries.

Graph 2.27: **Sweden - Real GDP growth and contributions**



The economy's growth momentum, however, looks set to weaken. This partly reflects the impact of the expected slowdown in Sweden's main trading partners but also largely stems from weakening domestic demand and a cooling labour market. Corporate investment is consequently set to moderate, as is private consumption. As house prices have stabilised, residential construction investment is set to fall. With import growth lower, in line with internal demand, net trade will lend economic activity some support. Overall, real GDP growth is expected to slow down markedly to 1.3% in 2019, before picking up somewhat to 1.7% in 2020 on the back of slightly stronger private consumption.

Risks remain skewed to the downside. As a small open economy, Sweden remains vulnerable to external shocks. Investment and demand for exports could fall further in response to a more pronounced slowdown among major trading partners. At the same time, risks to the domestic economy also are tilted to the downside. Although house prices stabilised in 2018, a renewed decline could affect consumer confidence and further reduce household consumption to the extent that households would deleverage.

Headline inflation reached 2.0% on average in 2018, buoyed by energy prices and unprocessed food prices – partly reflecting hot and dry weather. However, core inflation, as measured by the overall index excluding energy and unprocessed food, was little more than 1% at the end of 2018, suggesting that underlying price trends remain subdued. As energy and food price increases are set to moderate and the pass-through of a weaker Swedish krona is set to fade, headline inflation is projected to fall to 1.7% in 2019 and to edge down slightly further to 1.6% in 2020. Core inflation is expected to pick up somewhat to reach around 1.5% on average in 2020.

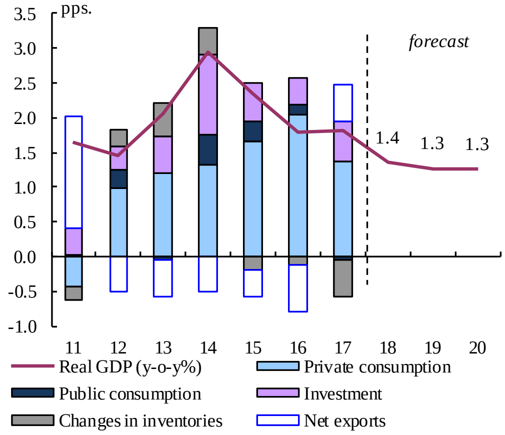
2.28. THE UNITED KINGDOM

UK GDP growth was subdued in 2018 and is expected to register a modest 1.4% for the year. While weather-related effects temporarily reduced growth in 2018-Q1, and boosted it in 2018-Q3, GDP data for October and November and high frequency indicators for December indicate that the underlying rate of growth slowed markedly in 2018-Q4. Survey evidence suggests that this slowdown is linked to heightened uncertainty over the UK's future trading relationship with the EU, which has negatively impacted consumer and business confidence and spending.

Given the ongoing ratification process of the Withdrawal Agreement in the EU and the UK, projections for 2019 and 2020 are based on a purely technical assumption of status quo in terms of trading relations between the EU27 and the UK. This is for forecasting purposes only and has no bearing on the talks underway in the context of the Article 50 process. Under this assumption, GDP growth is projected to remain weak at 1.3% in 2019. Expansionary fiscal measures announced in the 2018 autumn budget should provide a stimulus to growth in 2019. This is anticipated to be partly offset by a negative contribution to growth from net trade, with export growth expected to remain weak, in line with slowing growth in external demand.

Following a prolonged period of heightened uncertainty, business investment growth is projected to remain subdued. However, total investment growth will be supported by strong public investment in 2019. Private consumption growth is also forecast to remain weak as households take the opportunity of rising real wage growth to maintain savings. GDP growth is expected to be stable at 1.3% in 2020 with quarterly growth rates returning to around the recent average trend rate. As the purely technical assumption implies a relatively benign scenario, the risks to the 2019 baseline forecast are large and predominantly to the downside.

Graph 2.28: **The United Kingdom - Real GDP growth and contributions**



Consumer price inflation eased gradually from its peak of 3.1% in November 2017 to 2.1% in December 2018. This largely reflects the fading inflationary impact of the pound's depreciation in 2016. As the impact of the currency depreciation on consumer prices unwinds fully, inflation is forecast to ease to 1.8% in 2019. In 2020, increasing wage pressures and a stabilisation in oil prices should provide some upward price pressure, with inflation rising to 2.0%.

STATISTICAL ANNEX

Table 1: Gross domestic product, volume (percentage change on preceding year, 2000-2020) — 1.2.2019

	5-year averages						Winter 2019 forecast			*Autumn 2018 forecast*		
	2000-04	2005-09	2010-14	2015	2016	2017	2018	2019	2020	*2018*	*2019*	*2020*
Belgium	2.1	1.3	1.2	1.7	1.5	1.7	**1.4**	**1.3**	**1.2**	*1.5*	*1.5*	*1.4*
Germany	1.0	0.6	2.2	1.7	2.2	2.2	**1.5**	**1.1**	**1.7**	*1.7*	*1.8*	*1.7*
Estonia	7.3	0.9	3.8	1.9	3.5	4.9	**3.5**	**2.7**	**2.4**	*3.5*	*2.8*	*2.6*
Ireland	6.0	1.2	3.1	25.1	5.0	7.2	**6.8**	**4.1**	**3.7**	*7.8*	*4.5*	*3.8*
Greece	4.6	0.9	-4.9	-0.4	-0.2	1.5	**2.0**	**2.2**	**2.3**	*2.0*	*2.0*	*2.0*
Spain	3.7	1.8	-0.9	3.6	3.2	3.0	**2.5**	**2.1**	**1.9**	*2.6*	*2.2*	*2.0*
France	2.1	0.8	1.2	1.1	1.2	2.2	**1.5**	**1.3**	**1.5**	*1.7*	*1.6*	*1.6*
Italy	1.5	-0.5	-0.4	0.9	1.1	1.6	**1.0**	**0.2**	**0.8**	*1.1*	*1.2*	*1.3*
Cyprus	4.3	3.2	-1.7	2.0	4.8	4.2	**3.8**	**3.3**	**2.7**	*3.9*	*3.5*	*2.9*
Latvia	7.1	2.4	2.1	3.0	2.1	4.6	**4.7**	**3.1**	**2.6**	*4.1*	*3.2*	*2.9*
Lithuania	6.8	2.4	3.7	2.0	2.4	4.1	**3.6**	**2.7**	**2.4**	*3.4*	*2.8*	*2.5*
Luxembourg	3.9	2.1	3.0	3.9	2.4	1.5	**3.0**	**2.5**	**2.6**	*3.1*	*3.0*	*2.7*
Malta	2.6	2.1	4.1	10.6	5.7	6.6	**6.2**	**5.2**	**4.6**	*5.4*	*4.9*	*4.4*
Netherlands	1.8	1.5	0.6	2.0	2.2	2.9	**2.5**	**1.7**	**1.7**	*2.8*	*2.4*	*1.8*
Austria	2.0	1.4	1.2	1.1	2.0	2.6	**2.7**	**1.6**	**1.6**	*2.7*	*2.0*	*1.8*
Portugal	1.5	0.4	-0.9	1.8	1.9	2.8	**2.1**	**1.7**	**1.7**	*2.2*	*1.8*	*1.7*
Slovenia	3.6	2.3	0.2	2.3	3.1	4.9	**4.4**	**3.1**	**2.8**	*4.3*	*3.3*	*3.0*
Slovakia	3.9	5.1	2.7	4.2	3.1	3.2	**4.2**	**4.1**	**3.5**	*4.0*	*4.1*	*3.5*
Finland	3.2	0.8	0.5	0.1	2.5	2.8	**2.5**	**1.9**	**1.7**	*2.9*	*2.2*	*1.9*
Euro area	2.0	0.7	0.8	2.1	2.0	2.4	**1.9**	**1.3**	**1.6**	*2.1*	*1.9*	*1.7*
Bulgaria	5.2	4.7	1.1	3.5	3.9	3.8	**3.2**	**3.6**	**3.6**	*3.5*	*3.7*	*3.6*
Czechia	3.5	3.3	1.1	5.3	2.5	4.4	**2.9**	**2.9**	**2.7**	*3.0*	*2.9*	*2.6*
Denmark	1.6	0.3	1.2	2.3	2.4	2.3	**0.8**	**1.6**	**1.3**	*1.2*	*1.8*	*1.6*
Croatia	4.4	1.7	-0.9	2.4	3.5	2.9	**2.8**	**2.7**	**2.6**	*2.8*	*2.8*	*2.6*
Hungary	4.3	0.5	1.4	3.5	2.3	4.1	**4.8**	**3.4**	**2.6**	*4.3*	*3.4*	*2.6*
Poland	3.3	4.7	3.0	3.8	3.1	4.8	**5.1**	**3.5**	**3.2**	*4.8*	*3.7*	*3.3*
Romania	5.4	4.4	1.4	3.9	4.8	7.0	**4.0**	**3.8**	**3.6**	*3.6*	*3.8*	*3.6*
Sweden	3.0	1.0	2.4	4.5	2.7	2.1	**2.2**	**1.3**	**1.7**	*2.4*	*1.8*	*1.8*
EU27	2.1	0.9	0.9	2.3	2.1	2.6	**2.1**	**1.5**	**1.8**	*2.2*	*2.0*	*1.9*
United Kingdom	2.9	0.7	2.0	2.3	1.8	1.8	**1.4**	**1.3**	**1.3**	*1.3*	*1.2*	*1.2*
EU28	2.2	0.9	1.1	2.3	2.0	2.4	**1.9**	**1.5**	**1.7**	*2.1*	*1.9*	*1.8*

Table 2: Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter, 2018-02) — 1.2.2019

	2018/1	2018/2	2018/3	2018/4	2019/1	2019/2	2019/3	2019/4	2020/1	2020/2	2020/3	2020/4
Belgium	0.3	0.3	0.3	0.3	0.2	0.4	0.4	0.3	0.3	0.2	0.2	0.2
Germany	0.4	0.5	-0.2	0.2	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.3
Estonia	0.1	1.4	0.4	1.2	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6
Ireland	-0.5	2.1	0.9	:	:	:	:	:	:	:	:	:
Greece	0.5	0.4	1.0	:	:	:	:	:	:	:	:	:
Spain	0.6	0.6	0.6	0.7	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4
France	0.2	0.2	0.3	0.3	0.3	0.3	0.4	0.4	0.3	0.3	0.3	0.3
Italy	0.3	0.1	-0.1	-0.2	0.0	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Cyprus	1.1	0.8	0.8	:	:	:	:	:	:	:	:	:
Latvia	1.5	1.2	1.7	1.1	0.3	0.4	0.6	0.6	0.6	0.6	0.6	0.6
Lithuania	1.0	0.9	0.1	1.6	0.5	0.5	0.5	0.6	0.6	0.6	0.5	0.4
Luxembourg	1.0	0.1	0.6	:	:	:	:	:	:	:	:	:
Malta	0.9	2.5	3.6	:	:	:	:	:	:	:	:	:
Netherlands	0.5	0.7	0.2	0.3	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Austria	0.9	0.5	0.4	0.2	0.4	0.5	0.5	0.5	0.4	0.3	0.2	0.2
Portugal	0.4	0.6	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5
Slovenia	0.6	0.9	1.3	0.3	0.9	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Slovakia	1.0	1.2	1.1	0.6	1.1	1.1	1.1	1.0	0.9	0.7	0.6	0.5
Finland	0.9	0.3	0.4	0.9	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3
Euro area	0.4	0.4	0.2	0.2	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.3
Bulgaria	0.9	0.8	0.7	0.3	1.1	1.1	1.1	1.0	0.8	0.8	0.7	0.7
Czechia	0.5	0.6	0.6	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.6	0.6
Denmark	0.7	0.1	0.7	0.7	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Croatia	0.8	1.0	0.6	0.6	0.5	0.7	0.8	0.7	0.6	0.7	0.4	0.5
Hungary	1.3	1.1	1.3	1.1	0.5	0.7	0.7	0.7	0.6	0.6	0.6	0.6
Poland	1.6	1.1	1.7	0.4	0.9	0.9	0.9	0.8	0.8	0.8	0.7	0.7
Romania	0.3	1.5	1.9	0.1	0.9	0.9	1.0	1.0	0.9	0.8	0.8	0.8
Sweden	0.8	0.5	-0.2	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5
EU27	0.5	0.5	0.3	0.3	0.4	0.4	0.5	0.5	0.4	0.4	0.3	0.3
United Kingdom	0.1	0.4	0.6	0.2	0.2	0.2	0.3	0.3	0.4	0.4	0.4	0.4
EU28	0.4	0.5	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.3	0.4

Table 3: Harmonised index of consumer prices (national index if not available), (percentage change on preceding year, 2000-2020) 1.2.2019

	5-year averages							Winter 2019 forecast		*Autumn 2018 forecast*	
	2000-04	2005-09	2010-14	2015	2016	2017	2018	2019	2020	*2019*	*2020*
Belgium	2.0	2.2	2.0	0.6	1.8	2.2	2.3	**1.9**	**1.7**	*2.1*	*1.6*
Germany	1.5	1.8	1.6	0.1	0.4	1.7	1.9	**1.4**	**1.5**	*1.9*	*1.6*
Estonia	3.5	5.2	3.2	0.1	0.8	3.7	3.4	**2.8**	**2.3**	*3.3*	*2.5*
Ireland	4.1	1.8	0.5	0.0	-0.2	0.3	0.7	**0.9**	**1.4**	*1.2*	*1.4*
Greece	3.4	3.1	1.3	-1.1	0.0	1.1	0.8	**0.7**	**1.3**	*1.2*	*1.0*
Spain	3.2	2.7	1.8	-0.6	-0.3	2.0	1.7	**1.2**	**1.5**	*1.7*	*1.5*
France	2.0	1.7	1.6	0.1	0.3	1.2	2.1	**1.4**	**1.7**	*1.7*	*1.6*
Italy	2.5	2.1	1.9	0.1	-0.1	1.3	1.2	**1.0**	**1.3**	*1.5*	*1.4*
Cyprus	3.1	2.2	1.9	-1.5	-1.2	0.7	0.8	**0.7**	**1.2**	*1.3*	*1.4*
Latvia	3.2	8.4	1.2	0.2	0.1	2.9	2.6	**2.7**	**2.1**	*2.7*	*2.4*
Lithuania	0.6	5.5	2.0	-0.7	0.7	3.7	2.5	**2.2**	**2.1**	*2.2*	*2.1*
Luxembourg	2.8	2.7	2.4	0.1	0.0	2.1	2.0	**1.6**	**1.8**	*2.0*	*1.8*
Malta	2.6	2.5	1.9	1.2	0.9	1.3	1.7	**1.8**	**1.9**	*1.9*	*2.0*
Netherlands	3.0	1.6	1.8	0.2	0.1	1.3	1.6	**2.4**	**1.7**	*2.5*	*1.7*
Austria	1.8	1.9	2.3	0.8	1.0	2.2	2.1	**2.0**	**2.0**	*2.1*	*2.0*
Portugal	3.3	1.9	1.6	0.5	0.6	1.6	1.2	**1.3**	**1.6**	*1.6*	*1.6*
Slovenia	6.9	3.0	1.8	-0.8	-0.2	1.6	1.9	**1.9**	**2.1**	*2.3*	*2.2*
Slovakia	7.8	2.8	2.0	-0.3	-0.5	1.4	2.5	**2.5**	**2.4**	*2.6*	*2.4*
Finland	1.8	1.8	2.3	-0.2	0.4	0.8	1.2	**1.4**	**1.8**	*1.6*	*1.8*
Euro area	2.2	2.0	1.7	0.0	0.2	1.5	1.7	**1.4**	**1.5**	*1.8*	*1.6*
Bulgaria	6.4	7.1	1.5	-1.1	-1.3	1.2	2.6	**2.0**	**1.8**	*2.0*	*1.8*
Czechia	2.5	2.7	1.7	0.3	0.6	2.4	2.0	**2.1**	**1.9**	*2.2*	*1.8*
Denmark	2.1	2.0	1.6	0.2	0.0	1.1	0.7	**1.2**	**1.7**	*1.5*	*1.7*
Croatia	3.2	3.4	1.8	-0.3	-0.6	1.3	1.6	**1.4**	**1.4**	*1.5*	*1.4*
Hungary	7.1	5.1	3.2	0.1	0.4	2.4	2.9	**2.8**	**3.0**	*3.3*	*3.0*
Poland	4.3	2.8	2.2	-0.7	-0.2	1.6	1.2	**2.3**	**2.7**	*2.6*	*2.7*
Romania	26.0	6.8	4.0	-0.4	-1.1	1.1	4.1	**3.3**	**3.1**	*3.5*	*3.3*
Sweden	1.9	1.9	1.0	0.7	1.1	1.9	2.0	**1.7**	**1.6**	*1.9*	*1.6*
EU27	3.0	2.4	1.8	0.0	0.2	1.6	1.8	**1.6**	**1.7**	*1.9*	*1.7*
United Kingdom	1.2	2.5	2.9	0.0	0.7	2.7	2.5	**1.8**	**2.0**	*2.0*	*1.9*
EU28	2.7	2.3	2.0	0.0	0.3	1.7	1.9	**1.6**	**1.8**	*2.0*	*1.8*

Table 4: Harmonised index of consumer prices (national index if not available), (percentage change on preceding year, 2018-02) 1.2.2019

	2018/1	2018/2	2018/3	2018/4	2019/1	2019/2	2019/3	2019/4	2020/1	2020/2	2020/3	2020/4
Belgium	1.6	2.2	2.7	2.8	2.4	2.0	1.7	1.6	1.8	1.8	1.7	1.5
Germany	1.3	1.9	2.1	2.1	1.7	1.5	1.3	1.1	1.5	1.5	1.5	1.5
Estonia	3.2	3.3	3.5	3.7	3.2	3.1	2.6	2.5	2.5	2.5	2.2	2.1
Ireland	0.5	0.4	1.0	0.9	0.7	0.8	0.9	1.1	1.3	1.4	1.4	1.5
Greece	0.3	0.7	0.9	1.1	0.8	0.6	0.8	0.8	1.3	1.3	1.2	1.2
Spain	1.1	1.8	2.3	1.8	1.2	1.2	1.1	1.2	1.4	1.4	1.5	1.5
France	1.5	2.1	2.6	2.2	1.6	1.3	1.3	1.5	1.7	1.7	1.7	1.7
Italy	0.9	1.0	1.7	1.5	1.2	1.3	0.9	0.8	1.0	1.2	1.4	1.4
Cyprus	-0.8	0.8	1.6	1.5	0.7	0.6	0.6	0.7	1.1	1.1	1.2	1.3
Latvia	2.0	2.4	2.9	2.9	2.7	3.0	2.6	2.3	2.3	2.0	2.0	2.1
Lithuania	3.1	2.5	2.2	2.3	2.1	2.1	2.2	2.2	2.2	2.2	2.0	2.0
Luxembourg	1.2	1.9	2.5	2.4	2.0	1.5	1.3	1.4	1.7	1.8	1.8	1.8
Malta	1.3	1.7	2.4	1.6	1.8	1.7	2.0	1.7	1.7	1.8	1.9	2.1
Netherlands	1.3	1.5	1.8	1.8	2.5	2.4	2.3	2.2	1.9	1.8	1.7	1.7
Austria	2.0	2.1	2.2	2.1	2.1	1.9	2.0	2.0	2.0	2.0	1.9	1.9
Portugal	0.9	1.2	1.8	0.8	1.0	1.2	1.4	1.5	1.5	1.6	1.7	1.7
Slovenia	1.5	2.1	2.1	2.0	1.9	2.0	1.7	1.8	1.8	1.9	2.2	2.4
Slovakia	2.4	2.9	2.7	2.1	2.8	2.6	2.4	2.4	2.3	2.4	2.4	2.3
Finland	0.8	1.0	1.4	1.5	1.8	1.5	1.3	1.2	1.5	1.8	1.9	1.9
Euro area	1.3	1.7	2.1	1.9	1.6	1.5	1.3	1.3	1.5	1.5	1.6	1.6
Bulgaria	1.6	2.4	3.6	3.0	2.7	2.2	1.5	1.7	1.7	1.7	1.8	1.8
Czechia	1.7	2.1	2.3	1.8	2.1	2.1	2.1	2.1	2.0	1.9	1.8	1.7
Denmark	0.5	0.9	0.7	0.7	1.1	1.1	1.2	1.4	1.6	1.7	1.7	1.7
Croatia	1.1	1.8	2.0	1.3	1.4	1.2	1.4	1.4	1.2	1.3	1.5	1.4
Hungary	2.0	2.8	3.5	3.3	3.0	3.0	2.5	2.7	3.6	3.1	2.8	2.7
Poland	1.0	1.1	1.4	1.1	1.8	2.3	2.5	2.6	2.7	2.7	2.7	2.8
Romania	3.7	4.5	4.6	3.5	3.3	3.4	3.3	3.3	3.2	3.2	3.1	3.1
Sweden	1.7	2.0	2.2	2.2	2.1	1.6	1.3	1.8	1.6	1.6	1.5	1.6
EU27	1.3	1.7	2.1	1.9	1.7	1.5	1.4	1.4	1.6	1.6	1.7	1.7
United Kingdom	2.7	2.4	2.5	2.3	2.0	1.8	1.7	1.8	1.9	2.0	2.1	2.1
EU28	1.5	1.8	2.2	2.0	1.7	1.6	1.5	1.5	1.7	1.7	1.7	1.7

Box .1: Some technical elements behind the forecast

The Winter 2019 (interim) forecast provides an update of the outlook of the Autumn 2018 forecast of 8 November 2018 and focuses on GDP and inflation developments in all EU Member States.

Given the ongoing ratification process of the Withdrawal Agreement in the EU and the UK, projections for 2019 and 2020 are based on a purely technical assumption of status quo in terms of trading relations between the EU27 and the UK. This is for forecasting purposes only and has no bearing on the talks underway in the context of the Article 50 process.

The cut-off date for taking new information into account in this forecast was 31 January 2019.

ESA 2010

The source for all tables is the European Commission, unless otherwise stated. Historical data for the Member States are based on the European System of Accounting (ESA 2010). 2019 and 2020 are forecast years. 2018 GDP data are also forecast, except for AT, BE, FR, IT, ES, LT, LV, PL and DE.

External assumptions

This forecast is based on a set of external assumptions, reflecting market expectations at the time of the forecast. To shield the assumptions from possible volatility during any given trading day, averages from a 10-day reference period (between 14 and 25 January) were used for exchange and interest rates, and for oil prices.

The technical assumption regarding exchange rates was standardised using fixed nominal exchange rates for all currencies. This technical assumption leads to an implied average USD/EUR rate of 1.14 in 2019 and 2020. The average JPY/EUR is 124.33 in 2019 and 2020.

Interest rate assumptions are market-based. Short-term interest rates for the euro area are derived from futures contracts. Long-term interest rates for the euro area, as well as short- and long-term interest rates for other Member States are calculated using implicit forward swap rates, corrected for the current spread between the interest rate and swap rate. In cases where no market instrument is available, the fixed spread vis-à-vis the euro area interest rate is taken for both short- and long-term rates. As a result, short-term interest rates are assumed to be -0.3% in 2019 and -0.1% in 2020 in the euro area. Long-term euro area interest rates are assumed to average 0.3% in 2019 and 0.5% in 2020.

Commodity price assumptions are also based on market conditions. According to futures markets, prices for Brent oil are projected to be on average 61.2 USD/bbl in both 2019 and 2020. This would correspond to an oil price of 53.6 EUR/bbl in 2019 and 2020.

Trade policies

This forecast is published against a background of elevated trade tensions. The forecast pencils in only the measures that have been implemented until the cut-off date:

- In January 2018, the US implemented safeguard tariffs on solar panels and washing machines from all countries (20 to 30 percent tariffs on imports worth $10.3 billion, combined).
- On 23 March 2018, US duties of 25% and 10% respectively on imports of steel and aluminium

Table 1:
Technical assumptions

		Winter interim 2019 forecast		*Autumn 2018 forecast*	
	2018	2019	2020	2019	2020
3-month EURIBOR (percentage per annum)	-0.3	**-0.3**	**-0.1**	*-0.2*	*0.2*
10-year government bond yields (percentage per annum) (a)	0.4	**0.3**	**0.5**	*0.7*	*0.9*
USD/EUR exchange rate	1.18	**1.14**	**1.14**	*1.15*	*1.15*
JPY/EUR exchange rate	130.38	**124.33**	**124.33**	*130.10*	*130.10*
GBP/EUR exchange rate	0.88	**0.88**	**0.88**	*0.88*	*0.88*
EUR nominal effective exchange rate (annual percentage change) (b)	4.8	**-1.0**	**0.0**	*0.6*	*0.0*
Oil price (USD per barrel)	71.5	**61.2**	**61.2**	*80.6*	*76.7*
Oil price (EUR per barrel)	60.7	**53.6**	**56.3**	*69.9*	*66.5*

(a) 10-year government bond yields for the euro area equal the German government bond yields.
(b) 42 industrial countries EU-28, TR CH NR US CA JP AU MX NZ KO CN HK RU BR.

(Continued on the next page)

Box (continued)

went into effect. Among the nations affected China responded by imposing tariffs (mainly on aluminium waste and scrap as well as food), on imports worth about $2.5 billion, while several countries gained temporary or permanent or exemptions (e.g. Argentina, Australia, Brazil and South Korea, some of which promised to adhere to voluntary export limits).

- On 1 June 2018, the exemptions granted to the EU ([1]), Canada and Mexico ended. The US measures are set to affect EU exports worth €6.4 billion in 2017, phased in 2 steps.

- On 20 June 2018, the European Commission exercised ([2]) its rights under WTO rules and adopted a regulation enacting the EU's rebalancing measures in response to the US tariffs on steel and aluminium, which in a first stage target a list of products worth €2.8 billion. These measures took effect on 22 June 2018. Both Mexico and Canada also retaliated, imposing tariffs on the US exports of equal value to the affected value of their respective imports.

- On 6 July 2018 US 25% tariffs on $34 billion of Chinese imports go into effect, the first phase of its $50 billion list realised in response to the US administration report finding China conducting unfair trade practices related to technology transfer, intellectual property, and innovation under Section 301 of the Trade Act of 1974. On 23 August 2018, US tariffs on the remaining $34 billion of Chinese imports go into effect. The US tariffs are followed up by China's retaliation with a 25% tariff on $50 billion of US imports.

- US 10% tariffs on $200 billion of Chinese imports take effect on 24 September 2018. China retaliates by imposing countermeasures on $60 billion of US exports (with tariff rates of 5% and 10%). The US administration announces an increase of the tariffs to 25% on 1 January 2019, which is subsequently postponed to 1 April 2019.

- As a sign of a (temporary) thaw in the China-US relations, the Chinese authorities reduce tariffs on car imports to 15%. The reduction includes the car imports from the US, for which duties had been raised in July to 40% in response to US hiking tariffs on a range of Chinese goods, as well as imports from other regions (from 25%).

- The US authorities have time until 17 February 2019 to issue a report concluding an investigation under Section 232 of the Trade Expansion Act of 1962 into whether automotive imports into US threatened national security. In the case of a positive answer, a further round on US imports of autos and car parts would be expected.

- Several important trade agreements were concluded in 2018. On 23/1/2018 11 countries including Australia and Japan concluded negotiations of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). The agreement entered into force on 30/12/2018 among the first six countries that had already ratified it. The EU and Japan's Economic Partnership Agreement entered into force on 1 February 2019. Canada, Mexico and the United Sates renegotiated NAFTA. The new agreement named United States-Canada-Mexico (USMCA) was signed end of 2018 and is awaiting ratification.

Calendar effects on GDP growth

The number of working days may differ from one year to another. The Commission's annual GDP forecasts are not adjusted for the number of working days, but quarterly forecasts are.

The working-day effect in the EU and the euro area is estimated to be limited in 2019, implying that adjusted and unadjusted annual growth rates differ only marginally (by up to ±0.1 pps.). However, in 2020 this difference will be larger, approximately 0.2 pps. in the euro area.

Geographical zones

Euro area: EA19 (BE, DE, EE, IE, EL, ES, FR, IT, CY, LV, LT, LU, MT, NL, AT, PT, SI, SK and FI).

European Union: EU28 (EA19, BG, CZ, DK, HR, HU, PL, RO, SE and UK).

EU27: EU28 without UK

([1]) European Commission (2018). 'European Commission reacts to the US restrictions on steel and aluminium affecting the EU'. *European Commission Press Release* 4006. May.

([2]) European Commission (2018). 'EU adopts rebalancing measures in reaction to US steel and aluminium tariffs'. *European Commission Press Release* 4220. June.