EUROPEAN ECONOMY

EUROPEAN COMMISSION
DIRECTORATE–GENERAL FOR ECONOMIC AND FINANCIAL AFFAIRS

Supplement A
Economic trends
No 4 – April 1999

http://europa.eu.int/comm/dg02

In this number :
Spring 1999 Forecasts for 1999–2000[1]

Highlights

- *After the healthy growth observed in 1998, the EU as a whole and the euro area will slow down significantly this year as a result of the deteriorated international environment, but the slow–down will be temporary.*
- *Stockbuilding, while having kept activity up in 1998, unwinds in the light of weak export demand which, together with less investment growth, leads to the sharper than expected growth deceleration in 1999.*
- *Sound fundamentals and robust domestic demand in the EU, especially private consumption, should lift the economy to a higher growth path in 2000, when the external environment is expected to improve.*
- *Thanks to the temporary nature of the dip, job creation should only be mildly affected and labour shedding is also likely to be limited allowing the unemployment rate to continue falling, albeit more slowly.*
- *The slowdown is temporary and conditions for sustained economic growth and job creation remain intact.*
- *Moderate commodity prices, in particular the price of oil and favourable domestic conditions are driving headline inflation to historically low levels. Nominal interest rates are also at record lows.*
- *In 1998, government accounts improved further thanks mainly to stronger economic growth and lower interest payments. No deterioration is expected in 1999, despite the slowdown in activity.*

TABLE 1: **Main features of the spring 1999 forecasts: EU–15([a])**

				Spring 1999 Forecast		Difference with Autumn 1998 (b)	
	1996	**1997**	**1998**	**1999**	**2000**	**1999**	**2000**
	Main economic indicators						
GDP growth (a)	1.8	2.7	**2.9**	**2.1**	**2.7**	–0.3	–0.1
Investment in equipment (a)	3.9	5.0	**8.4**	**3.8**	**5.3**	–1.4	–0.8
Employment (a)	0.3	0.5	**1.1**	**0.8**	**0.8**	–0.1	–0.1
Unemployment rate (c)	10.9	10.6	**10.0**	**9.6**	**9.2**	0.1	0.2
Inflation (d)	2.7	2.1	**1.5**	**1.3**	**1.6**	–0.4	–0.2
Government deficit (% GDP)	–4.1	–2.3	**–1.5**	**–1.5**	**–1.3**	–0.1	–0.1
Government debt (% GDP)	72.8	71.7	**69.7**	**68.6**	**67.0**	–0.4	–0.3
Current account balance (% GDP)	0.9	1.5	**1.2**	**0.9**	**0.9**	–0.5	–0.5
p.m.: GDP growth EUR–11 (a)	1.6	2.5	**3.0**	**2.2**	**2.7**	–0.4	–0.2

([a]) Real annual percentage change unless otherwise stated.
([b]) A "+" ("–") sign means a higher (lower) positive figure or a lower (higher) negative one compared to Autumn 1998.
([c]) Percentage of the civilian labour force.
([d]) Private consumption deflator.

Overview

In the EU, overall, 1998 turned out well, but since the last quarter of that year the outlook became clouded due to more negative indicators. In consequence, the slowdown in 1999 is likely to be more pronounced than expected in last Autumn Forecasts and real GDP growth will be limited to 2.1 %. However, fundamentals remain healthy and the dip is expected to be only temporary so that an acceleration of real GDP growth to 2.7 % in 2000 is possible. A similar picture emerges for the euro area where the average growth rate is marginally above the EU as a whole in 1999 and at the same level in 2000. The slowdown is provoked by the impact of faltering export demand on investment and stock–building. Private consumption remains largely unscathed under the influence of growing real income and buoyant consumer confidence which contrasts sharply with the negative mood in industry.

Some SE Asian countries may be starting to climb out of the trough, but the devaluation of the Brazilian Real underlined the fragility of the emerging markets and tipped Latin–America into recession. In Japan, despite the fiscal stimulus injected and measures taken to consolidate the banking system, the economy will be facing another, albeit smaller, contraction this year. The Russian crisis is sharper than foreseen and is having a greater impact on the Central and Eastern European countries. All this has led to a further deterioration of the international environment which the good news coming from the US could not offset. However, the world economy is expected to recover gradually, so that by 2000 it will not exert any longer a negative influence on the EU.

At 1.1 % employment creation was particularly strong in 1998 in the EU. The temporary dip in activity in 1999 should have only a mild effect on net employment creation in the EU, which is expected to be at 0.8 % per year corresponding to about 2.5 million jobs in 1999–2000. Also labour shedding should be limited. Over the same period the number of unemployed could decrease by 1.1 million to about 14.5 million in 2000 (9.2 % of the labour force).

There are few threats to price stability and the risk of deflation is further away than the low headline inflation may suggest. Due to large terms–of–trade movements and the decline in interest rates, differences between some of the inflation measures are larger than usual. The deflator of private consumption for the euro area has been revised down to 1.2 % in 1999 and to 1.5 % in 2000.

The general government deficit (1.5 % of GDP in the EU) turned out better than expected in 1998, mainly thanks to stronger growth and lower interest rates. The underlying budgetary positions, however, did not show significant improvements. Based on the measures in national budgets presented by the Member States the general government deficit should remain at 1.5% of GDP in 1999 and should see a small reduction in 2000 to 1.3 % for the EU as a whole.

International environment

Fears of a new international financial crisis were renewed after the collapse of the Brazilian Real peg to the dollar in January. Although some financial instability followed, mainly in Latin America, the reaction of markets in the rest of the world was muted and financial turmoil on the scale seen in August–September 1998 following Russia's unilateral debt moratorium has not been repeated. Moreover, the US economy grew more strongly than expected in 1998 and the forecast for 1999 has been revised upwards as a consequence. There are signs that SE Asia may have passed the trough, as evidenced by recovering currencies and equity prices and by an end to the decline in output in some countries. The Japanese economy is expected to start growing again in the second half of 1999.

Overall *world GDP* growth is estimated to have turned out in 1998 broadly as forecast at 2.1%. This rate of growth is expected to be maintained in 1999 with an acceleration to 2.9% following in 2000. Given the expected slowdown in the EU economy in 1999, GDP growth in the world excluding the EU is set to accelerate earlier and more rapidly.

Import growth in the world excluding the EU decelerated very sharply from 10.6% in 1997 to 2.3% in 1998 as demand collapsed in the economies most affected by financial crisis. A reacceleration over the forecasting period is assumed in line with an expected pick–up in world GDP growth. Nevertheless, the rise in import growth to 5.3% by 2000 remains well below the growth rates of around 10% or more recorded between 1993 and 1997. Extra–EU export market growth is assumed to remain at 3.6% in 1999 before rising to 5.7% in 2000.

The *US* economy grew more strongly than expected in 1998 and the forecast for 1999 has been revised upwards as a consequence. After a buoyant 3.9% in 1998, a soft–landing is expected with growth slowing to 2.7% this year and 2.2% next year.

By contrast recession in *Japan* turned out deeper than expected in 1998 (–2.9%) and negative growth is now expected to persist in 1999 (–1.3%). However the latest data indicate that the rate of decline is slowing. Positive growth is expected by the second half of 1999 as the reform of the banking sector improves confidence and the fiscal stimulus packages take effect, with an external boost provided by an expected pick–up in demand from Japan's major trading partners in Asia.

The worst of the financial turmoil in SE Asia appears to have passed and signs of improvement in the real economies of the affected countries are now starting to appear as well: output has stopped shrinking and foreign trade is starting to recover. Economic growth in *Asean 4 + South Korea* fell by 9.2% in 1998 but is expected to turn slightly positive this year (+0.3%) and pick up further in 2000 (3.0%). Growth already slowed sharply in *Latin America* in 1998 to 1.3% as a consequence of the trade and contagion effects of the financial crises in Asia and Russia. The impact of January's events in Brazil suggests output will decline further and move into negative territory this year (–2.2%).

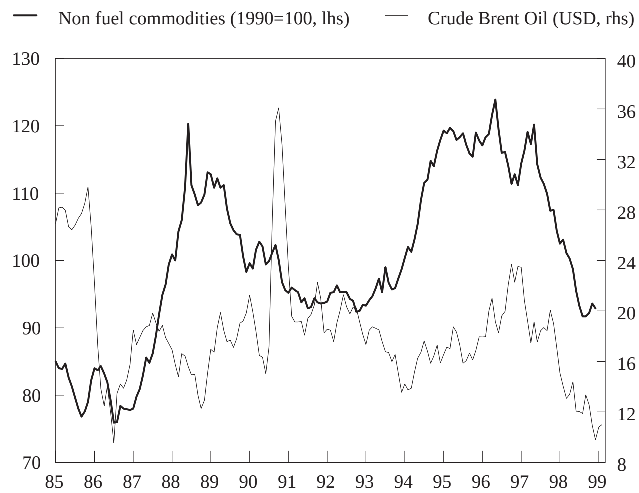
The outlook for the *FSU* (former Soviet Union) is not encouraging: after finally achieving positive growth of 1.1% in 1997, a decline of 2.7% is estimated for 1998 and growth is expected to remain negative throughout the forecasting period (–4.0% in 1999, –1.4% in 2000). The adverse effects

TABLE 2: **International environment** ([a])

		1996	1997	1998	Spring 1999		Difference with Autumn 1998	
					1999	**2000**	**1999**	**2000**
					Real GDP growth			
Asia		6.6	5.3	**2.3**	**3.2**	**3.9**	–0.5	–1.1
of which	**Japan**	3.9	0.8	**–2.9**	**–1.3**	**0.5**	–1.9	–1.2
	ASEAN4+South Korea(b)	7.3	4.2	**–9.2**	**0.3**	**3.0**	0.3	–0.8
USA		3.5	4.0	**3.9**	**2.7**	**2.2**	0.6	0.0
EAC (c)		4.8	3.1	**2.2**	**2.4**	**3.1**	–1.3	–1.3
FSU		2.3	1.1	**–2.7**	**–4.0**	**–1.4**	–3.3	0.3
of which	**Russia**	0.0	0.8	**–5.0**	**–6.0**	**–2.5**	–3.0	2.5
OPEC–Indonesia		3.3	3.5	**0.1**	**1.8**	**3.3**	–0.4	–0.2
Latin America		4.1	4.7	**1.3**	**–2.2**	**0.8**	–4.4	–2.9
of which	**Brazil**	3.0	3.6	**0.2**	**–4.2**	**–1.0**	–5.7	–4.4
Africa		4.2	3.9	**3.4**	**3.7**	**4.4**	–0.4	–0.2
World excl EU–15		4.9	4.5	**1.9**	**2.1**	**2.9**	–0.6	–0.8
World		4.2	4.2	**2.1**	**2.1**	**2.9**	–0.6	–0.6
					World trade			
World import growth		7.7	10.2	**4.2**	**4.1**	**5.6**	–0.8	–0.3
World import growth excl. EU–15		9.9	10.6	**2.3**	**3.6**	**5.3**	–0.8	–0.2
Extra–EU–15 exp. market growth		8.5	10.8	**3.6**	**3.6**	**5.7**	–1.5	–0.3

(a) Annual percentage change.
(b) ASEAN4: Indonesia, Malaysia, Philippines, Thailand.
(c) Europe Agreement Countries: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

GRAPH 1: **Commodity prices**



of developments in the FSU and a slowdown in the EU mean GDP growth in the *EAC* (Europe Agreement countries, see table for definition) is now estimated to have come in lower in 1998 (2.2%) than forecast in the autumn but a slight pick–up to 2.4% is forecast for this year, with a stronger acceleration to 3.1% in 2000.

The loss in demand resulting from the crises in emerging markets, particularly in Asia, has resulted in a drop in commodity prices. While the effect has been positive for net importers, including the EU, pushing external balances up and reducing inflationary pressure, the reverse is true for net exporting countries relying heavily on raw material exports. Although there is some divergence among *non–oil commodity prices*, overall a decline by roughly 10 % was seen last year. Since oversupply is expected to continue for several years a further drop in prices is expected in 1999 and

Box 1: Millennium bug

The macroeconomic impact of the Millennium Bug is difficult to assess. Estimates of the spending devoted to fixing the problem vary widely both in terms of the amounts involved and the time horizon. There is even more uncertainty concerning the probability and potential costs of disruption resulting from a failure to fix the problem, but most forecasters agree that effects on output are unlikely to be permanent. Thus the Millennium Bug problem is not explicitly modelled in these forecasts.

Expenditure aimed at keeping existing systems in working order will not directly raise output. Replacing hardware or software that is too expensive or impossible to fix will require new investment. These effects are likely to have been spread over a number of years: some organisations will have made their preparations well in advance and others later. Scale efficiencies may exist where this work is carried out in conjunction with upgrades for other reasons, for example in preparation for the launch of the euro. But there is nevertheless likely to be some offset in terms of lower investment in other areas or at a later date.

There may be a precautionary build–up of inventories in late 1999 by households and business to guard against systems failures at the turn of the year, but there would be an offsetting effect in early 2000.

It cannot be excluded that some minor disruption occurs in the real economy and/or financial system due to technical failures when the year 2000 arrives. However the impact on productivity should be small thanks to the benefits gained from the modernisation of systems. Past experience of other disruptive shocks suggests that severe or long–lasting output effects are unlikely. For example, a seven–month closure of clearing banks in Ireland in 1970 resulted in a major disturbance to the payments system but had very little effect on overall spending or activity; similarly a three–day working week during the winter of 1974 in the United Kingdom, imposed due to power restrictions during a coal miners' strike, was disruptive but overall macroeconomic effects are difficult to identify.

only a slight rebound in 2000 on the back of a recovery of world economic activity. The *oil price* (around 13 USD/barrel for Brent oil in March) is around the average value recorded in 1998 which represented a fall of over 30% compared to the previous year. Despite efforts by OPEC and other producers to cut production it is expected that the current supply overhang will not be eliminated in the short run. Thus a further small drop in price is assumed for 1999 which is then reversed in 2000.

The economy of the European Union

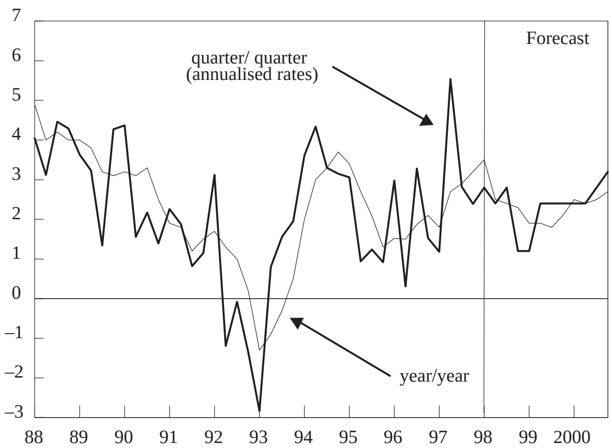
1. Recent economic developments

Economic activity in the EU at the end of 1998 developed roughly as anticipated in the previous forecast. In particular, domestic demand proved remarkably robust, to an extent that had not been observed since the beginning of the 1990s. Details on each EU country can be found further on in the country section.

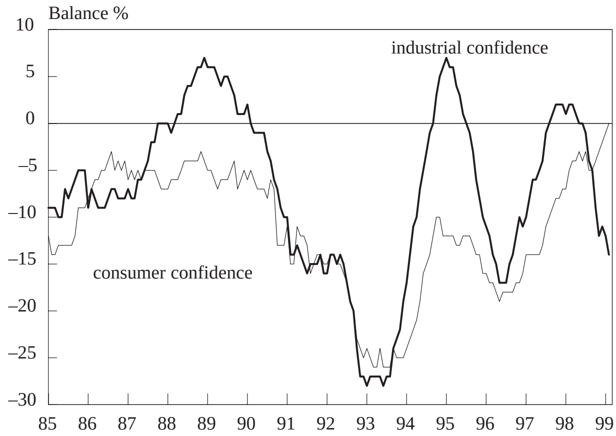
According to Eurostat figures, *GDP* in 98Q4 grew by 0.2% qoq and 2.3% yoy in the EU, resulting in a 2.9% growth rate in the EU for the year 1998 as a whole (i.e. as in the Autumn 1998 Forecast). If one concentrates on the profile, it appears clearly that quarterly GDP growth peaked at the turn of 1997/98, and has since been on a declining trend. Domestic components have remained robust in 1998. In particular, private consumption (which grew by 2.8%), fuelled by increases in real disposable income, a fall in the saving ratio of households and employment growth, contributed very positively to GDP growth. Private investment accelerated strongly in 1998 as well. The improved domestic demand outlook together with favourable financing conditions boosted equipment investment (8.4%) and also allowed a pick–up in investment in the construction sector (1.8%) following several years of subdued growth. GDP growth in 1998 would have easily surpassed 3% had it not been for the contribution of net exports, which became increasingly negative from 98Q1 onwards.

The growth rate of *industrial production* in the EU peaked during 98Q1 at rates around 5 to 6% yoy. It decelerated gradually thereafter to 3.0% yoy in 98Q3. More recently, in December 1998, the growth rate was almost flat. The same slowing is evident in all major countries. The latest figures available point to growth which is virtually flat in Germany, France and the UK, negative in Italy, but still of the order of 3 to 4% yoy in Spain. Leading indicators point to further weakening ahead. A reduction of output in the industrial sector seems very likely in the EU as a whole during the first half of 1999.

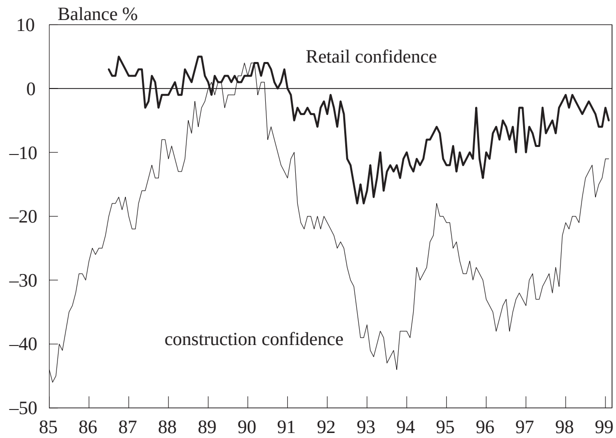
GRAPH 2: **Real GDP growth in EU–15**



GRAPH 3: **Industrial and consumer confidence in EU–15**

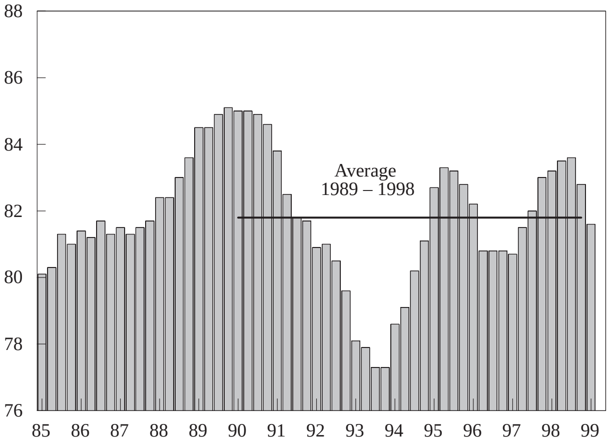


GRAPH 4: **Construction and retail confidence in EU–15**



Survey indicators to February 1999 continue to display a widening gap between business confidence and consumer confidence. This divergence that first appeared in March–April 1998, has been lasting for an unusually long period of time. Industrial confidence in the EU has fallen below its long–term average, while consumer confidence stands above its peak of the previous cycle. An explanation for this constellation has to be sought in the nature of the external shock which hit the EU economy. Indeed, the dichotomy applies to all sectors of economic activity according to their exposure to the international competition. Typically, industrialists operating in the highly exposed sector of manufacturing goods report more pessimism than can be seen from the surveys in the relatively sheltered sectors of construction and retail trade. The capacity utilisation ratio in the manufacturing industry eased somewhat to 81.6% in January 1999, compared to a peak of 83.6% in 98Q3.

GRAPH 5: **Capacity utilisation in manufacturing industry in EU–15**

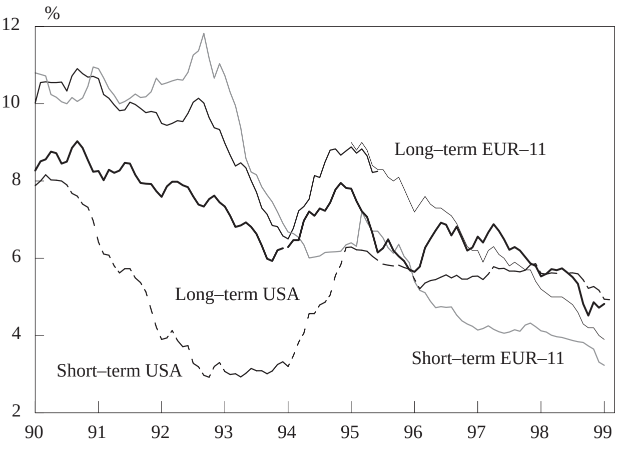


2. Monetary developments

While last year financial markets had directly or indirectly been heavily influenced by the turbulence especially in Asia, Russia and Latin America, early 1999 has seen a certain revival of domestic factors. Low rates of inflation, central banks' determination to focus on price stability as well as the strength of domestic activity received a lot of attention. The stronger emphasis financial markets put on domestic factors is reflected in differences between developments in Europe and elsewhere both in terms of interest rates and exchange rates.

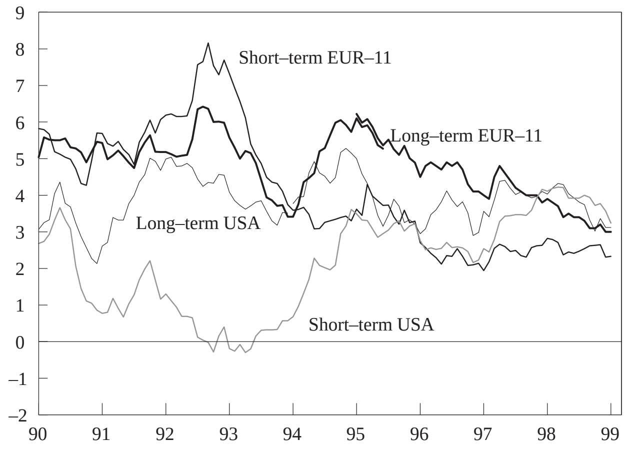
Short–term interest rates in the euro area stayed close to three percent in the first three months of 1999. This level had already been approached on 3 December 1998 when national central banks in the designated euro area simultaneously cut key interest rates to 3.0%, except Italy, where interest rates were finally cut to 3.0% on 23 December. The expected smooth convergence toward this relatively low nominal starting level brought substantial interest rate cuts for many Member States through the course of last year, sometimes more than halving the level seen one year earlier. Taking over responsibility in 1999, the ECB has set an interest rate of 3% applicable to its refinancing operations, resulting in three–month money market rates close to 3%.

GRAPH 6: **Long and short term interest rates in EUR–11 and USA**



Long–term interest rates in the euro area continued to decline in the first weeks of 1999 when government bond yields reached all–time lows close to 3¾% (10–year benchmark) before the decline of interest rates came to a halt. The decline in early 1999 followed the already substantial drop in long–term rates observed last year. Apart from global factors like the "flight to quality" phenomenon triggered by financial crisis, institutional change and internal factors contributed to the declining trend. Among the institutional factors the disappearance of exchange rate uncertainty in the euro area has gradually eliminated risk premia that were associated with this risk until the move to Stage Three of EMU. Among the internal factors it is mainly the high level of price stability and the outlook for its continuation, together with progress in budgetary consolidation which are reflected in recent developments. In fact, the favourable outlook for price stability seems to have created confidence in financial markets and thereby reduced inflationary expectations. As many of these factors will remain in place up to the forecast horizon no significant changes in long–term interest rates are assumed up to the end of 2000. Temporary changes in long–term rates like those observed during the first quarter of 1999 appear to be consistent with this assumption as their explanation is mainly provided by developments in capital markets outside the euro area where inflationary fears had already led to an increase in US long–term rates somewhat earlier.

GRAPH 7: **Real interest rates** (nominal rates minus CPI, HICP from 1996)



Short–term interest rates outside the euro area have declined in most industrial countries throughout 1998 and early 1999. In the ERM2, Danish key rates were cut several times, and Greek short–term rates have returned to the downward path which they left following last year's devaluation that accompanied the start of Greece's ERM participation. For the two Member States neither participating in EMU nor ERM2, short–term rates in Sweden are already approaching the euro area's level, while in the United Kingdom the rate is still considerably above that of the euro area. Outside Europe the Fed has cut US rates three times (by 25 bps each time) lowering three–month rates slightly below the 5% level. Japanese short–term rates, which were already the lowest of all industrial countries, have declined again in 1999 towards 0.3% and the overall situation does not suggest major changes over the forecast period.

Box 1: Technical Points

Unchanged policy assumption

The forecasts are made under the assumption of unchanged policies. Only measures adopted or known in sufficient detail are included. This is of particular importance in the field of budgetary and monetary policy.

The public finance figures up to 1998 are those notified by the Member States in March 1999 under the Excessive Deficit Procedure. These figures have been validated by Eurostat. With respect to 1999 all countries have presented their budgets. The forecasts for 1999 assume the budgets are fully implemented. For 2000, the no–policy change assumption implies that presently known measures (if not one–offs) and trends are extrapolated. Figures are compatible with ESA79 accounting rules.

The evolution of monetary variables is governed by technical assumptions. Depending on the case exchange rates are held constant in nominal or real terms starting from a level observed in the recent past. Interest rates are set in order to have a neutral impact on the economy.

ESA95

The new system of national accounts in the EU will be ESA95 from April 1999. Until then Member Countries may use the old system of accounts, called ESA79. However, some countries have already introduced or plan to introduce ESA95 before April 1999. Denmark was the first country to use ESA95 accounts and the Autumn 1998 forecasts were established on the new statistical basis for the first time. The only exception concerns the government deficit presented in the current forecasts for Denmark, which is still on an ESA79 basis, in order to be compatible with the reported public finance data (Regulation (EC) N° 3605/93). An adjustment line has been introduced in order to allow for the difference in the government deficit under ESA95 and ESA79.

The UK moved to ESA95 in September 1998. The tables since the Autumn 1998 forecasts have, hence, been prepared in line with the ESA95 definitions. The changes to historical data are significant and embody other methodological changes including re–basing. In Ireland they have already included some of the ESA95 changes, notably on the trade side, but until it is possible to have a full set of national accounts based on the new system the forecasts continue to be based on the ESA79 system.

Finland moved to ESA95 in the beginning of 1999, but the current forecasts were prepared according to the old classification because the full new data set is not yet available.

The euro in the forecasts

On 1.1.99 the currencies of the Member States adopting the single currency were replaced by the euro, but during the transitional period until the end of 2001, the national currency units will continue as subdivisions of the euro. Statistical series in national currencies have been kept in the same denomination in the forecasts. With regard to series in ECU, they have been left unchanged for the past, but are expressed in euro from 1.1.99. The euro series are the statistical continuation of the ECU series.

The fixed conversion rates of the euro

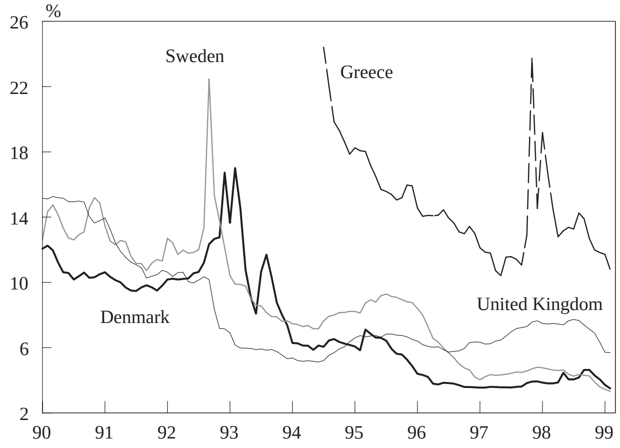
The irrevocably fixed conversion rates between the euro and the currencies of the Member States adopting the euro are:

1 EURO	=	40.3399	Belgian francs
	=	1.95583	German marks
	=	166.386	Spanish pesetas
	=	6.55957	French francs
	=	0.787564	Irish pounds
	=	1936.27	Italian lire
	=	40.3399	Luxembourg francs
	=	2.20371	Dutch guilders
	=	13.7603	Austrian schillings
	=	200.482	Portuguese escudos
	=	5.94573	Finnish marks

Current account

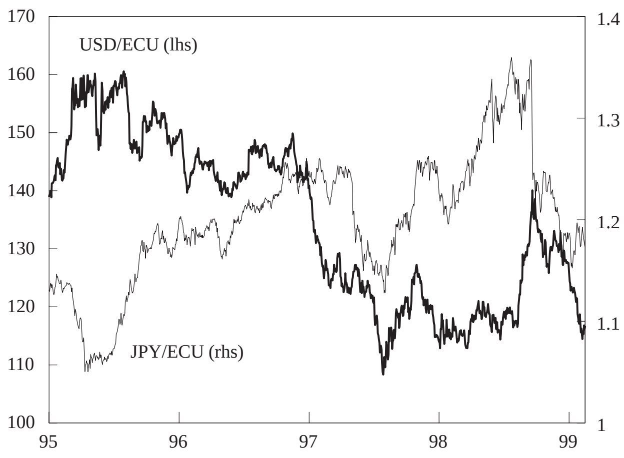
The figures on the current account in the EU overstate the surplus because imports within the EU appear to be underrecorded. If bilateral trade flows were correctly measured, the sum of intra–EU exports should be equal by definition to the sum of intra–EU imports. There is a problem since 1993 when the gap between the two series widened. It is due to the introduction of the Single Market which simplified international transactions by abolishing some formalities at the border, but this occurred at some cost of statistical accuracy. Eurostat is attempting to remedy this shortcoming. Based on provisional data published by Eurostat, the current account surplus for the EU as a whole is estimated to be only 0.9% of GDP in 1997, instead of 1.5% when based on the aggregation of data from national sources, implying a discrepancy of 0.6 % of GDP. For the euro area the adjusted current account surplus is estimated at 1.4% in 1997 (compared to a surplus based on data from national sources of 1.8%), implying a discrepancy of 0.4 percentage point. In the forecast tables the EU and EUR11 aggregates for the current account balance continue for the time being to be based on the sum of the national figures.

GRAPH 8: **Short term interest rates in the 4 non Euro area countries**



Long–term interest rates outside the euro area declined throughout 1998 both in European economies and in the USA and Japan. While the global factors have been the same as those described for the euro area, the internal factors have been rather different. In the four EU Member States outside the euro area yields have increased by approximately 50 bps between early January and early March 1999 which still implies for all except Greece current levels below those in the first half of 1998 and below last year's average. While in the USA and Japan long–term rates declined in 1998, this year long–term bond yields have increased to levels substantially above that observed last year. In US markets increased inflationary concern caused by a surprisingly strong performance of the US economy and market expectations concerning the future stance of monetary policy contributed to a sharp increase towards 5½% in March (from 4¾% in the fourth quarter of 1998). In Japan

GRAPH 9: **ECU/EURO exchange rates**

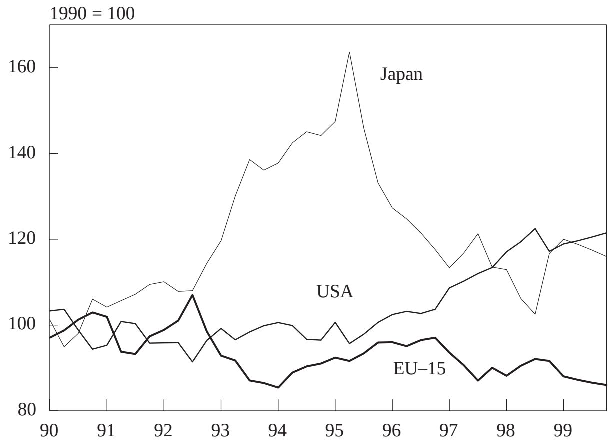


the increase in yields occurred already in January when markets anticipated the huge increase in public borrowing that is expected as a consequence of fiscal measures.

Foreign exchange markets remained relatively calm in the last quarter of 1998 following a period of months of a weakening US dollar. The rebound of the dollar that has taken place since early 1999 has restored the situation that prevailed one year ago. This development is also reflected in the USD/euro rate which declined from a starting rate of 1.18 to rates close to 1.10 (mid–March), returning approximately to the level of the USD/Ecu rate seen one year ago. Also the development of the JPY/USD exchange rate supports the view of a strengthening dollar. After a period of recovery from the rather high JPY/USD rates of last summer, the Japanese currency has again lost some ground vis–à–vis the US dollar. Sterling sustained its strength throughout last year and its current level of 0.67 GBP/euro is close to last year's average but somewhat stronger than in early January, exhibiting a pattern similar to that of the USD/ECU rate. Since ERM2 started on 1 January 1999 both the DKK and the GRD have remained roughly stable against the euro.

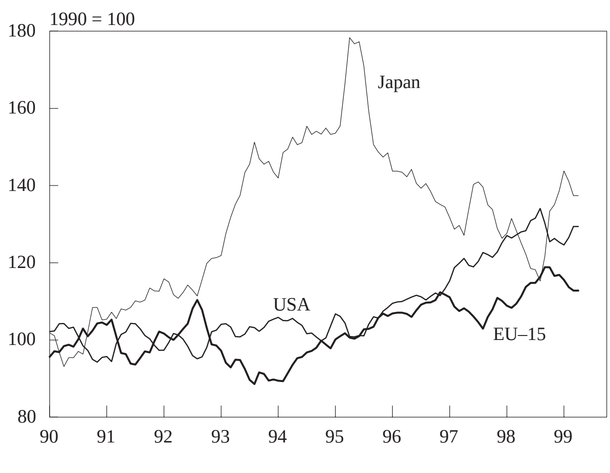
The formulation of the *exchange rate assumptions* takes into account the fixed conversion rates prevailing since the introduction of the euro on 1 January. The technical assumptions for exchange rates now imply constant nominal exchange rates between ERM2 currencies and the euro, and constant real exchange rates between the euro and ERM2 currencies against the other European and non–European currencies. Exchange rates between the euro and non–ERM2 currencies for 99Q1 are set at the average of historical data between 11 February and 11 March. The choice of this period implies a USD/euro rate of 1.10 (equivalent to 1.77 DEM/USD). This means a depreciation by 1.2% this year on the average of the nominal effective exchange rate of the euro area vis–à–vis other industrialised economies.

GRAPH 11: **Real effective exchange rates**
(unit labour costs in total economy, v–à–v rest of 24 ind.countries)

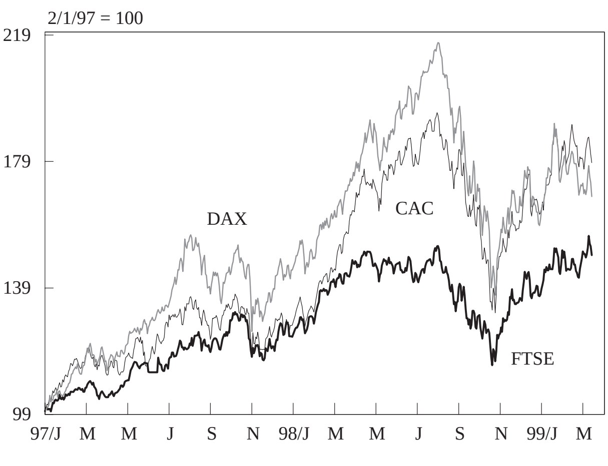


Stock markets in the euro area displayed a V–shaped evolution since mid–July 1998. The decline by approximately one third until early October has since been reversed. In mid–March 1999, euro area stock market indices are approximately 15% higher than one year ago. A similar volatility has been observed on US markets where stock prices went sharply down in autumn last year and where the rebound has pushed stock prices to levels considerably above those seen one year earlier. Japanese stock prices which were on a downward trend from the mid–nineties have shown some strength in the first half of March 1999 following a period of stabilisation around last year's average. Given the global slowdown of economic growth, the overall performance of stock markets appears relatively strong.

GRAPH 10: **Nominal effective exchange rates**
(v–à–v rest of 24 industrial countries)



GRAPH 12: **EU stock markets**



3. The external shock has a major impact on the outlook

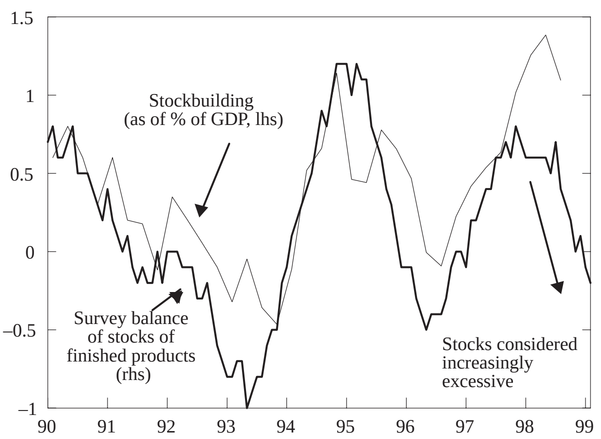
Turning to the forecast period, the slowdown envisaged this year in the EU is now sharper than was expected 5 months ago. The negative impact from the cut in the growth rates of world GDP and trade had been underestimated in the previous forecast. In particular, the negative spillover from the external environment to the exposed sector had been underestimated. This negative drag is also forecast to last longer than previously thought. Instead of 2.4% as forecast last autumn, GDP growth in the EU is now expected to grow by 2.1% in 1999.

Among *demand components*, net exports and equipment investment are likely to suffer most in 1999, while consumption and construction should prove more robust. Indeed, the external shock which affects the European economies has asymmetric effects across economic agents: positive for consumers but negative for industrial producers, while the service sector is relatively sheltered. On balance, households' confidence will cushion the slowdown, but lower stockbuilding, subdued investment and weak net exports together will knock a substantial amount off growth this year.

In 1999, both exports and imports of goods and services are forecast to slow further towards respectively 3.5% and 4.7%. *Net exports* are forecast to post another negative contribution of –0.4 point to GDP growth.

The (industrial) supply side of the economy is affected by steadily declining business confidence. It is not only the downgraded export order–books which fuel this pessimism, but also falling producer prices in the face of rigid costs (wages and interest rates). Falling import prices could only partially offset these negative influences. In this situation of pressure on profits, industrialists are expected to scale down their investment plans and run down their inventories. *Equipment investment* is forecast to slow to an increase of 3.8%.

GRAPH 13: **Stockbuilding and its assessment in EU–15**



The sector of manufacturing industry represents only part of total value–added or employment. More sheltered sectors such as services or construction should prove more robust. In particular, *construction investment* is expected to continue accelerating to 3.5% in 1999.

Fluctuations in *inventory investment* can be an important propagation mechanism for business cycles. They sometimes explain a considerable fraction of changes in GDP, as was the case in a positive way in 1998. Based on survey evidence, the large stockbuilding was not considered excessive in the first half of last year, suggesting it was forward looking behaviour to meet future demand. In the second half of last year, inventories were considered increasingly excessive. Therefore, the accumulation of stocks will be lower and the contribution of inventories to GDP growth is set to turn negative in 1999. However, one has to be aware of measurement difficulties. Under the headline "inventories" are often grouped true inventories plus statistical discrepancies. This could also explain the difference observed in 1998 in some countries between the assessment

TABLE 3: **Composition of growth: EU–15**

				Spring 1999 Forecast			Difference with Autumn 1998		
	1995	**1996**	**1997**	**1998**	**1999**	**2000**	**1998**	**1999**	**2000**
				Real annual percentage change					
Private consumption	1.8	2.2	2.0	2.8	2.6	2.6	0.2	0.1	0.2
Government consumption	0.5	1.3	0.1	1.3	1.7	1.6	–0.3	0.0	–0.3
Gross fixed capital formation	3.7	1.4	2.8	4.9	3.7	4.8	0.2	–0.9	–0.6
– Equipment	8.5	3.9	5.0	8.4	3.8	5.3	0.5	–1.4	–0.8
– Construction	0.4	–0.9	0.3	1.8	3.5	4.4	–0.2	–0.6	–0.3
Exports of goods and services	8.4	5.1	9.7	5.4	3.5	5.6	–1.1	–1.2	–0.5
Imports of goods and services	7.4	4.2	9.2	7.4	4.7	6.1	–0.3	–1.1	–0.5
GDP	2.4	1.8	2.7	2.9	2.1	2.7	0	–0.3	–0.1
				Contribution to change in GDP					
Consumption	1.2	1.6	1.3	1.9	1.9	1.8	0.1	0.1	0.0
Investment	0.7	0.3	0.5	1	0.7	1.0	0.1	–0.2	–0.1
Inventories	0.1	–0.4	0.5	0.6	–0.2	0.0	0.2	–0.1	0.0
Exports	0.9	0.8	1.8	0.4	0.3	0.7	–0.4	–0.2	–0.1
Final demand	2.9	2.3	4.1	3.9	2.8	3.6	–0.1	–0.4	–0.1
Imports (minus)	–0.6	–0.5	–1.4	–1	–0.7	–0.9	0.1	0.1	0.0
Net exports	0.3	0.3	0.4	–0.5	–0.4	–0.1	–0.2	–0.1	0.0

TABLE 4: **Features of the spring 1999 forecasts: EUR–11**

				Spring 1999 Forecast			Difference with Autumn 1998		
	1995	**1996**	**1997**	**1998**	**1999**	**2000**	**1998**	**1999**	**2000**
				Main economic indicators					
GDP growth	2.2	1.6	2.5	**3.0**	**2.2**	**2.7**	0.0	–0.4	–0.2
Employment	0.4	0.0	0.2	**1.1**	**0.9**	**0.9**	0.0	–0.1	–0.1
Unemployment rate	11.5	11.8	11.8	**10.9**	**10.4**	**9.9**	–0.1	0.0	0.0
Inflation	2.9	2.5	1.9	**1.4**	**1.2**	**1.5**	–0.1	–0.4	–0.2
Government deficit (% GDP)	–4.8	–4.1	–2.5	**–2.1**	**–1.9**	**–1.7**	0.2	0.0	0.0
Government debt (% GDP)	72.9	75.3	75.1	**73.4**	**72.6**	**71.2**	–0.4	0.1	0.3
Current account balance (% GDP)	0.8	1.2	1.8	**1.7**	**1.5**	**1.4**	–0.2	–0.4	–0.4

reported in the surveys and the high level of stockbuilding displayed in national accounts.

Finally, *private consumption* should remain relatively strong. Unemployment is likely to continue declining because negative developments in industry are more than offset by positive ones in the services sector; declining inflation boosts purchasing power; low interest rates foster consumption. This bright environment for households is reflected by record high consumer confidence displayed in the surveys. According to the forecast, private consumption should grow by 2.6% (i.e. almost the same growth rate as in 1998).

As regards *2000*, a rebound in EU GDP growth to 2.7% is forecast, assuming robust domestic forces and a gradual improvement in the world environment. In sharp contrast to the years 1994–97 when foreign trade exerted a strongly positive influence on GDP growth and helped sustain activity, the EU will have to rely mainly on its own forces to realise the rebound. As already seen, private consumption is expected to be practically unscathed by the slowdown, which provides a robust outlook for producers. The slowdown in output growth is assumed to be only temporary and limited to the sector of manufactured goods. Demand expectations by industrialists seem to have reached a turning point, which would point to a recovery of corporate investment as from 99Q2. Following a year 1999 in which capacity and inventories unwind, equipment investment is forecast to re–accelerate in 2000. The contribution of inventories should return to neutral, while the construction sector is expected to continue recovering, benefiting in particular from continued low interest rates. The previously negative contribution of trade is likely to turn close to neutral, assuming a recovery in world demand.

To a large extent, the difference between the EU as a whole and the *euro area* is imputable to the UK economy, which is in a different position of the business cycle and hit by the strength of sterling. Given the weight of the euro area in the EU–15 aggregate, it is not surprising that differences are small. Expected GDP growth in 1999 in the euro area (2.2%) is mainly due to strong private consumption reflecting high levels of consumer confidence. All other components of domestic demand are now assessed as performing less strongly than expected last autumn. Export growth will be slower than last year and exceeded by import growth, thus reducing the trade surplus of the euro area. Inflationary pressures remain absent this year and only small increases in inflation rates are forecast for next year. Employment creation (0.9%) goes on but at a lower pace than last year. Among the economies belonging to the euro area Ireland remains the fastest growing economy while Italy and Germany are expected to lag behind the EU average.

4. Further improvement in the employment field

Employment growth in the EU turned out particularly strong in 1998. The 1.1% increase (corresponding to the creation of 1.7 million jobs) represents the best performance recorded since 1990. Despite the sharp slowdown expected this year in output growth, employment in the EU is still forecast to grow by 0.8% each year in 1999 and 2000 (corresponding to the creation of around 2.5 millions jobs over the two years). Indeed, the labour–content of GDP growth has increased over recent years, against the background of a stable macroeconomic framework and under the impact of the active labour market policies implemented in most member countries. Another explanation is the gradual shift towards the more labour intensive service sector. It is worth noticing also that Germany put a halt in 1998 to previously steadily falling employment levels and that small positive employment growth rates are forecast in 1999 and 2000.

GRAPH 14: **Unemployment rate**
(Eurostat harmonised rate)

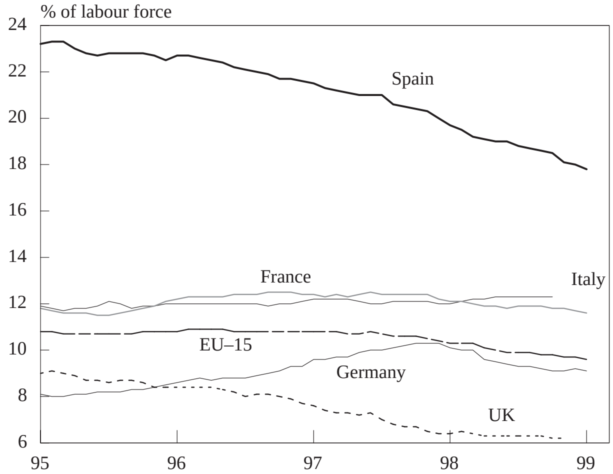


TABLE 5: **Labour market outlook: EU–15**

Annual percentage change	1991–95	1996–2000	1997	Spring 1999 Forecast 1998	1999	2000	Difference with Autumn 1998 1998	1999	1999
Population of working age (15–64)	0.4	0.2	0.2	**0.2**	**0.3**	**0.3**	–0.1	0.0	0.0
Labour force	0.1	0.4	0.4	**0.4**	**0.4**	**0.4**	0.0	0.0	–0.1
Employment	–0.5	0.7	0.5	**1.1**	**0.8**	**0.8**	–0.1	–0.1	–0.1
Employment (change in millions)	–4.3	4.9	0.7	**1.7**	**1.2**	**1.3**	0.0	–0.1	–0.1
Unemployment rate (%)	10.0	10.1	10.6	**10.0**	**9.6**	**9.2**	0.0	0.1	0.2
Labour productivity, whole economy	2.0	1.7	2.2	**1.7**	**1.3**	**1.8**	0.0	–0.2	0.0

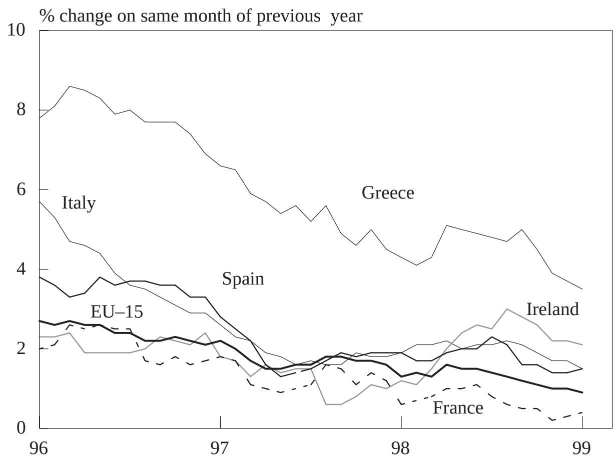
As a consequence of these favourable developments, *unemployment* in the EU declined by a substantial amount in 1998. It fell from 10.6% of the labour force in 1997 to 10.0% in 1998. A further decrease, at a pace of around a half percentage point per year is forecast in 1999 and 2000. Turning to the Member States, all, except the UK, continue to display a decline in unemployment rates over the forecasting period. In this respect, the best performances are expected in Spain and Ireland, where unemployment rates should be cut by 3 percentage points between 1998 and 2000.

5. Inflation is heading towards record lows

Inflation in the EU continued to decrease in 1998 as it has been doing steadily since 1991. The inflation rate (measured by the deflator of private consumption) in the EU fell from 2.1% in 1997 to 1.5% in 1998. As regards 1999, it is now expected to fall further to the record low of 1.3%. A similar trend is evident in most member countries. In the Autumn Forecast, inflation in 1998 and 1999 had been over–estimated. In particular, in France, Ireland, Luxembourg, the Netherlands, Finland and Sweden the downward revision for 1999 between the present forecast and the previous forecast exceeds half of a percentage point. As regards 2000 as well, a downward revision has been made to the EU inflation rate, which is now forecast to increase slightly to 1.6% (instead of 1.8%).

In particular falling import prices, expressed both in US dollars and national currency, pulled inflation down in 1998 and led to a positive terms of trade effect. This explains why in some Member States the discrepancy between the deflator of GDP and of private consumption is unusually large. The latter is dampened by the declining import prices, while the former is not. The annual rise of the Harmonised Index of Consumer Prices for the EU as a whole fell to 0.9 % in January 1999 and in several Member States to below 0.5 %, under the influence of cheap imports. These low headline inflation rates have raised worries about deflation, defined as a generalised and sustained decline in prices and economic activity. These fears should not be exaggerated as the underlying rate of inflation, when volatile food and energy prices are excluded, is more stable and has declined less spectacularly. The underlying rate of inflation is estimated to be around 1.2 %, suggesting that deflation is further away than is perhaps suggested by a first reading of the headline figure. In addition, current levels of economic activity do not point towards any risk of this kind.

GRAPH 15: **Harmonised index of consumer prices**



Taking a somewhat longer historical perspective, beyond the recent disinflationary consequence of the external shock affecting the EU economy (falling oil and commodity prices, falling producer prices, increased competition in the tradeable goods sector), a remarkable degree of price stability has been obtained in the EU. Moderate wage developments have contributed to this achievement. Nominal wage increases are expected to remain subdued (around 3 % in 1999 and 2000). However, weak productivity growth, especially in 1999, will bring about a relatively sharp increase in nominal unit labour costs.

TABLE 6: **Inflation outlook – EU–15**

Annual percentage change	1995	1996	1997	Spring 1999 Forecast 1998	1999	2000	Difference with Autumn 1998 1998	1999	2000
Private consumption deflator	3.0	2.7	2.1	**1.5**	**1.3**	**1.6**	–0.1	–0.4	–0.2
GDP deflator	3.0	2.4	1.8	**1.9**	**1.7**	**1.8**	0.1	–0.4	–0.2
Conpensation per employee	3.4	3.5	3.0	**2.3**	**2.9**	**3.1**	–0.1	–0.3	–0.1
Unit labour costs	1.6	1.9	0.8	**0.5**	**1.6**	**1.2**	–0.1	–0.1	–0.2
Import prices of goods	4.1	0.3	0.8	**–2.1**	**–0.2**	**1.8**	–0.6	–0.2	0.1

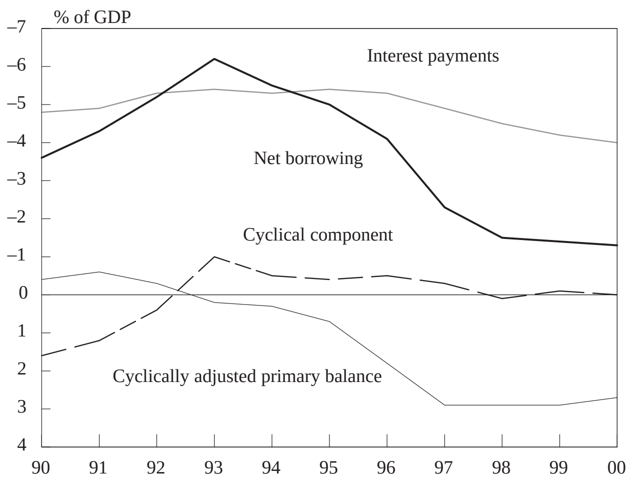
TABLE 7: **General government balance** (as % of GDP)

				Spring 1999		Stability/Convergence programme			
	1996	**1997**	**1998**	**1999**	**2000**	**1999**	**2000**	**2001**	**2002**
B	–3.1	–1.9	**–1.3**	**–0.9**	**–0.6**	–1.3	–1.0	–0.7	–0.3
DK	–0.9	0.4	**0.8**	**2.8**	**2.9**	2.5	2.8	2.6	**(a)**
D	–3.4	–2.7	**–2.1**	**–2.2**	**–2.1**	–2.0	–2.0	–1.5	–1.0
EL	–7.5	–3.9	**–2.4**	**–2.1**	**–1.9**	–2.1	–1.7	–0.8	–
E	–4.5	–2.6	**–1.8**	**–1.6**	**–1.3**	–1.6	–1.0	–0.4	0.1
F (b)	–4.1	–3.0	**–2.9**	**–2.4**	**–2.0**	–2.3	–2.0	–1.6	–1.2
IRL	–0.3	1.1	**2.3**	**2.5**	**3.1**	1.7	1.4	1.6	–
I	–6.6	–2.7	**–2.7**	**–2.3**	**–2.1**	–2.0	–1.5	–1.0	–
L	2.8	2.9	**2.1**	**1.5**	**1.4**	1.1	1.2	1.3	1.7
NL (c)	–2.0	–0.9	**–0.9**	**–1.6**	**–1.3**	–1.3	–	–	1.1
A	–3.7	–1.9	**–2.1**	**–2.0**	**–1.9**	–2.0	–1.7	–1.5	–1.4
P	–3.3	–2.5	**–2.3**	**–2.0**	**–1.7**	–2.0	–1.5	–1.2	–0.8
FIN	–3.1	–1.2	**1.0**	**2.5**	**2.7**	2.4	2.2	2.1	2.3
S	–3.5	–0.7	**2.0**	**0.3**	**1.8**	0.3	1.6	2.5	–
UK (d)	–4.4	–1.9	**0.6**	**–0.1**	**–0.1**	–0.3	–0.3	–0.1	0.2
EU–15	–4.1	–2.3	**–1.5**	**–1.5**	**–1.3**	–1.4	–1.2	–0.8	–0.5
EUR–11	–4.1	–2.5	**–2.1**	**–1.9**	**–1.7**	–1.8	–1.6	–1.2	–0.8

(a) Surplus of 3.5% of GDP projected for 2005.
(b) Prudent scenario. Deficit of 1.7, 1.2 and 0.8% of GDP in 2000–2002 under favourable scenario.
(c) Cautious scenario. Deficit of 0.25% of GDP and surplus of 0.25% in 2002 under middle and favourable scenario respectively.
(d) Surplus of 0.1% of GDP projected for the financial year 2003/2004.

6. Budgetary efforts successful but slowing

GRAPH 16: **General Government balance in EU–15**



In *1998* the average government deficit in the EU as a percentage of GDP declined further to 1.5 %, which is better than expected in the Autumn 1998 Forecast. This result was largely obtained thanks to stronger growth and lower interest payments. The underlying budgetary position hardly improved in several Member States. For the first time, all Member States had a government balance in 1998 better than the deficit reference value of 3 % of GDP. The number of countries showing a surplus in their budgetary balances increased to six: Denmark, Ireland, Luxembourg, Finland, Sweden, and United Kingdom. However, six Member States still had a deficit of more than 2 % of GDP; in order of the size of deficit/GDP these countries were France, Italy, Greece, Portugal, Germany and Austria.

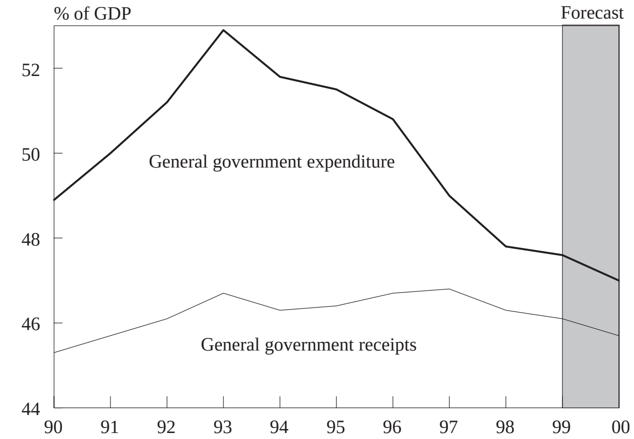
The public finance forecasts for *1999* are based on the measures presented in the national budgets for that year. A stabilisation in the general government deficit at 1.5 % of GDP for the EU as whole and further decline to 1.9% for the euro area is forecast. As economic conditions are less good, the reduction in the deficit/GDP ratio relies on the implementation of the announced measures and one cannot count on a large cyclical component. Lower interest payments should also contribute. The deficit as a percentage of GDP declines in all Member States except Germany and the Netherlands. The surplus in the UK becomes a small deficit.

Under the assumption of unchanged policies, it is expected that in *2000* the average deficit shrinks to 1.3 % of GDP for the EU and to 1.7 % for the euro area.

The main impetus for the reduction in the deficit ratio comes from *declining expenditure*, which has been falling as a proportion of GDP since 1994. Between 1998 and 2000 the share of government expenditure in GDP in the EU as a whole is expected to decrease by about 0.8 percentage points to 47.0%. However, general government receipts are also on a declining path as a proportion of GDP, having peaked in 1997, and are expected to represent 45.7% of GDP for the EU as a whole in 2000. This is the result of tax reforms and tax cuts.

The fall in the *debt* burden relative to GDP is expected to continue implying a decline of the EU average government debt from a peak level of 72.8% in 1996 to 68.6 % in 1999 and 67.0% in 2000. In France, Luxembourg, Finland and the United Kingdom the debt ratio remains below 60%. Denmark, Ireland, and Portugal have joined this group in 1998. In Ireland the debt/GDP ratio is expected to continue

GRAPH 17: **General government expenditures and receipts in EU–15**



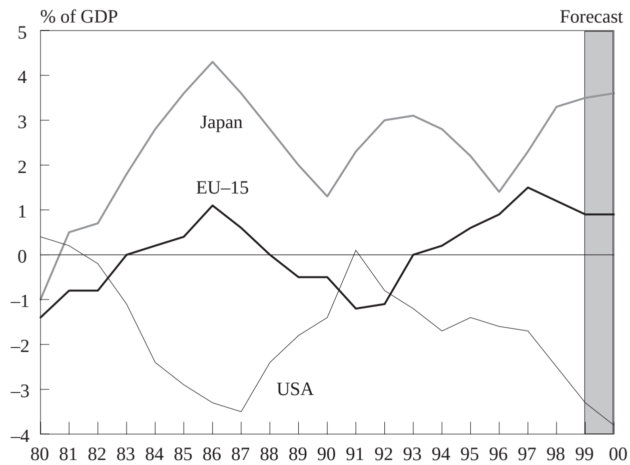
falling at a rapid pace (by about 10 percentage points annually) during the 1999–2000 period. By 2000 Ireland will have the second lowest debt/GDP ratio (34.5 %) in the EU, while in 1987 it had the second highest ratio in the EU (peak level of 114.9 %). In all Member States with debt/GDP ratios above 60 %, the ratio is expected to decrease over the forecasting period except in Germany where it remains stable at about 61.0 % of GDP. Further declines are also seen in countries with ratios already below 60 % of GDP with the exception of France where it turns down only in the last forecast year; in Luxembourg a rise from the current very low levels is expected.

7. Decline in the EU current account surplus

After peaking at 1.5% of GDP in 1997 and falling to 1.2% in 1998, the EU current account surplus is set to fall below 1% during the forecast period. The fall in the EUR–11 surplus from 1.8% in 1997 to 1.4% in 2000 is less marked because of the exclusion of sharply deteriorating UK balances. These new figures represent a significant downward revision to the current account forecasts made last autumn in line with the less favourable international environment now assumed. The already much larger Japanese current account surplus is set to increase further, in contrast to a rapidly widening US deficit.

The figures for the EU are biased upwards because of an underreporting of imports since the introduction of the Single

GRAPH 18: **Current account balance with the rest of the world**



Market (see Box 2). Estimates by Eurostat to correct for this suggest the current account surplus in 1997 amounted to 0.9% of GDP in the EU and 1.4% in the euro area (representing an upward bias in the uncorrected data of 0.6 and 0.4 percentage point respectively). Assuming this bias remains roughly constant, the forecast figures could be adjusted down by similar amounts.

The Member States' economies

Despite a difficult external environment, 1998 turned out to be a positive year in terms of output growth in most EU Member States. Ten economies displayed GDP growth rates between 2½ and 4% in 1998. Three economies (Finland, Luxembourg, Ireland) grew even more strongly, with Ireland ahead of all of them catching up further again at a double–digit rate. Only Italy and the United Kingdom lagged behind where the slower pace of expansion in the latter has to be attributed to the different cyclical position. Among the continental Member States cyclical positions are very similar and due to ongoing convergence the economic development appears roughly the same in many respects. Nevertheless, there are several country– specific elements that can explain differences among Member States concerning the economic situation and the outlook contained in the Spring 1999 Forecast.

Belgium

The pace of economic activity decelerated in the second half of 1998 mainly as a result of faltering external demand. In fact, the advanced indicator of economic activity, published by the Central Bank, has been falling since the fourth quarter of 1997 and more markedly since November 1998.

TABLE 8: **Main features of country forecast – Belgium**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	2.3	1.3	3.0	2.9	1.9	2.5
Priv. Cons.	0.9	1.8	2.1	3.7	2.4	2.3
GFCF	4.2	0.5	5.4	4.6	3.4	4.9
Exports (G&S)	6.0	2.2	7.1	3.2	3.1	4.4
Imports (G&S)	4.8	2.2	6.3	5.0	3.7	4.6
Inflation(a) (b)	–	1.8	1.5	0.9	1.0	1.3
Employment(a)	0.5	0.4	0.6	1.3	0.7	0.9
Unemployment(c)	9.9	9.7	9.2	8.8	8.3	7.8
Gen. Gov. bal.(d)	–4.0	–3.1	–1.9	–1.3	–0.9	–0.6

(a) Annual percentage change, (b) Harmonised index of consumer prices (c) % of labour force, (d) % of GDP.

As a result of further deceleration in activity during the first half of the year, real GDP growth is expected to slowdown from 2.9 % in 1998 to 1.9 % in 1999; however a rapid recovery is foreseen from the second semester of the year. These movements are mainly related to external developments while domestic demand is expected to continue to be supportive in 1999, reflecting favourable consumer confidence levels, low interest rates and import prices; nevertheless, increase in domestic demand should decelerate from 4.4 % in 1998 to 2.4 % in the current year.

Private consumption is foreseen to increase by 2.4 % reflecting improvement in employment, a moderate rise in real disposable income, and persisting consumer confidence. Private investment should decelerate from 5 % in 1998 to 4 % in 1999, as a result of a reduction in capacity utilisation registered in the latest months of 1998 and the likely postponement of investment decisions. Acceleration in gross capital formation and in exports will be the main driving factors of real GDP recovery in 2000 to 2.5 %.

Wage moderation and measures taken in recent years in favour of employment creation, particularly reduced social contributions for lower paid jobs, are expected to alleviate the negative impact of the slowdown in activity on the labour market. Total employment growth should decelerate from 1.3 % in 1998 to 0.7 % in 1999 and then recover somewhat to 0.9 % in 2000. The standardised unemployment rate is forecast to decline from 8.8% in 1998 to 8.3 % in 1999 and to about 7.8% in 2000.

Nominal compensation of employees per head is expected to rise on average by about 2¼ % per year in the period 1999–2000 implying real increases of about 1 percentage point in both years. Consumer prices are expected to increase by 1 % in 1999, as in 1998, and to slightly accelerate in 2000 as a result of stronger demand.

The general government deficit declined from 1.9 % of GDP in 1997 to 1.3 % in 1998 reflecting the effect of strong economic growth, in particular dynamic private consumption, and falling interest payments. On the basis of the current stance of fiscal policy, including a planned reduction in social security contributions in the coming years, the government deficit is estimated to fall to just under 1 % of GDP in 1999. In fact, the expected slowdown in economic activity should not have a significant effect on the projected deficit. The reduction in the deficit in 1999 will be partly due to the fact that one–off expenditures were undertaken in 1998, while lower than normal non–tax revenue were recorded; moreover, in 1999, roll–over of part of the public debt will be executed at declining interest rates.

Denmark

Following real GDP growth of about 2.7% in 1998, economic activity is expected to slow down in 1999 with annual GDP growth of about 1.7%. Growth of domestic demand should weaken to annual 2.0%, partly induced by the "Whitsun package". The "Whitsun package", which was adopted in June 1998, aims at stabilising domestic demand, the main instruments being different tax measures such as a reduction in the tax allowance for interest payments on mortgage loans. Exports, which in 1998 were depressed by the large labour market conflict, should improve. In the year 2000 a slight recovery is expected, with GDP growing by some 2.0%.

The weakening of domestic demand in 1999 is mainly due to a slackening of private consumption as the rise in both employment and housing prices, the main driving factors in 1998, is expected to fade out. Moreover, the effects of the Whitsun package should dampen the disposable income of households.

Investment is expected to slow considerably in 1999. This is in particular valid for equipment investment since demand expectations are at a very low level, profit margins are falling and capacity utilisation has decreased significantly during the last months. The growth rate of investment in non–residential construction should also decline, mainly as a result of a reduction in infrastructure investment. However, the growth rate of residential construction is anticipated to decrease only slightly as the effect of the reduced tax deduction for mortgage loans included in the Whitsun package will be largely offset by lower interest rates.

Exports are expected to increase somewhat, which mainly corresponds to a technical rebound following the labour market conflict in spring last year. However, they will remain moderate due to reduced growth in Danish export markets and a further loss of market shares. Import growth will be dampened by the general slowdown in domestic demand and, as a result, the balance of trade of goods and services should improve.

In 2000, the impact of the Whitsun package on both consumption and residential construction should be stronger since interest rates are assumed to increase slightly. The external contribution to GDP growth should further ameliorate and the balance in the trade of services should improve.

TABLE 9: **Main features of country forecast – Denmark**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	3.2	3.2	3.3	2.7	1.7	2.0
Priv. Cons.	3.2	2.7	3.6	3.4	2.0	1.8
GFCF	12.3	4.8	10.4	6.7	2.5	3.0
Exports (G&S)	4.7	4.2	4.3	1.2	2.8	3.8
Imports (G&S)	10.8	4.2	7.6	5.1	3.7	3.6
Inflation(a) (b)	–	2.1	1.9	1.3	1.7	1.6
Employment(a)	1.4	1.3	2.3	2.2	1.0	0.0
Unemployment(c)	7.2	6.8	5.6	5.1	4.6	4.8
Gen. Gov. bal.(d)	–2.4	–0.9	0.4	0.8	2.8	2.9

(a) Annual percentage change, (b) Harmonised index of consumer prices (c) % of labour force, (d) % of GDP.

Unemployment decreased significantly during 1998, reaching some 5%. The labour market is expected to remain rather tight and unemployment is forecast to decline further in 1999 and edge up in 2000.

The tight labour market in 1998 was reflected in wage increases of about 4.4%. This situation is expected to continue in 1999 and 2000 with wage increases of some 4%.

Consumer prices increased by 1.3% in 1998. In 1999, the HICP is expected to rise by about 1.7%. The increase in comparison to 1998 is due to higher indirect taxes on energy and the absence of the moderating effect of falling import prices observed in 1998. The increase in the HICP is forecast to level off in 2000.

Government finances are expected to remain sound. For 1999 a budget surplus of about 2.8% is forecast and the government's gross debt could fall below 55% of GDP. For 2000 a budget surplus of about 3.0% is expected and the gross debt could fall to close to 50% of GDP.

Germany

The German economy grew by a fairly strong 2.8% in 1998. Towards the end of the year, however, the negative effects of the international economic slowdown made themselves felt, particularly in the industrial sector. In the fourth quarter, GDP contracted by almost half a point on the quarter, despite robust private consumption. The forecast does not incorporate the revision in 1998 GDP data published in March 1999. The revision of the data, however, does not alter the scenario presented in the forecast.

GDP growth is likely to remain subdued in the first quarter of 1999. Depressed business confidence is likely to restrain investment; moreover, survey results seem to indicate that enterprises increasingly consider their stocks of finished products to be too high. This might well lead to destocking, and therefore lower production, in the first half of 1999. From then on, however, a gradual recovery is expected, because the effects of the international financial crisis should fade out and private consumption should be increasingly buoyant. The decline in interest rates, witnessed during 1998, should also tend to support economic growth. Overall, the economy should improve in the course of the year, but, owing to a weak overhang at the end of 1998 and to a subdued first quarter, GDP is expected to expand by only about 1.7% in 1999. In 2000, GDP growth could reach 2.4%.

TABLE 10: **Main features of country forecast – Germany**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	1.2	1.3	2.2	2.8	1.7	2.4
Priv. Cons.	2.2	2.1	0.5	1.7	2.6	2.2
GFCF	0.0	–1.2	0.1	1.0	1.8	3.1
Exports (G&S)	6.6	5.1	11.1	5.9	3.0	5.3
Imports (G&S)	7.3	2.9	8.1	5.2	3.8	4.8
Inflation(a) (b)	–	1.2	1.5	0.6	0.6	1.3
Employment(a)	–0.4	–1.3	–1.3	0.0	0.1	0.3
Unemployment(c)	8.2	8.9	9.9	9.4	9.0	8.7
Gen. Gov. bal.(d)	–3.3	–3.4	–2.7	–2.1	–2.2	–2.1

(a) Annual percentage change, (b) Harmonised index of consumer prices, (c) % of labour force, (d) % of GDP.

Private consumption will continue to accelerate in 1999, supported by a very low inflation rate and a sustained improvement of labour incomes. Furthermore, consumers' confidence has continued to improve in the last months, not least owing to the clear fall in unemployment from its peak at the end of 1997. In the year 2000, however, a slightly higher inflation is expected to erode part of the gains in households' purchasing power, leading to a slight deceleration in real private consumption growth rate. Government consumption is likely to grow less than GDP in both 1999 and in 2000.

Investment is not expected to show much dynamism in 1999. Business confidence declined sharply during 1998 and until now, no improvement has been seen. Manufacturers in particular are hit by a contraction in orders at the end of 1998, an acceleration in wages and, at least in the short term, a higher fiscal burden due to the closing of tax loopholes. Even though businesses operating in the service sector should benefit from stronger domestic demand, the now higher degree of uncertainty is likely to result in increased caution in decisions involving investments or personnel. The improvement in the economic situation will in due course lead to more investment, but this will pay off mostly in 2000. Thus, equipment investment is forecast to grow distinctly less in 1999 than in 1998. As for construction investment, the outlook remains subdued.

Exports declined sharply in the last quarter of 1998. Clearly, the deceleration of exports is set to continue in 1999; nevertheless, export markets should begin to recover this year. Furthermore, exports will also be supported by the reversal of the currency appreciation of the second half of 1998. The improvement should be clearer in 2000 as the effects of the international crisis fade out. Imports, stimulated by higher private consumption, should outpace exports, leading to a negative overall growth contribution in 1999. The external growth contribution is, however, expected to become positive again in 2000.

The labour market situation is not expected to improve much in 1999. The increase in the budget for active labour market policies envisaged in the 1999 budget will, however, on average avoid a deterioration of the situation compared to 1998. Stronger growth should again lead to net job creation by the private sector in the year 2000. Against this background and also thanks to demographic trends, unemployment is expected to decrease further, but will stay close to 4 million on an annual average basis.

Despite a 1–point increase in the VAT rate in April 1998, inflation fell to only 0.2% year–on–year by early 1999, thanks to sharp declines in import prices and unit labour costs. CPI inflation should remain well below 1% in 1999, even though wages growth and unit labour costs are expected to accelerate compared to 1998. In 2000, only a marginal pick–up in inflation is expected.

The general government deficit declined further in 1998, from 2¾% to close to 2% of GDP. Given the economic slowdown and low inflation, which reduces the growth of nominal GDP, a marginal increase in the deficit is expected in 1999, even though budgetary planning continues to be oriented towards containing expenditure. The debt ratio should remain close to present levels throughout the forecast period.

Greece

The performance of the Greek economy continued to improve: GDP growth accelerated while significant progress was achieved in curbing inflation and correcting fiscal imbalances. In March 1998, the drachma entered the ERM at a central rate representing a 12.1% devaluation of the currency. Domestic demand, in particular private consumption, slowed somewhat in 1998, under the combined impact of the devaluation and the moderate wage settlement. Investment activity continued to be strong while exports contributed to the acceleration in real output to an estimated rate of growth of 3.7%. Real output growth might decelerate temporarily in 1999 due to less dynamic export activity but domestic demand is expected to accelerate this year. Private consumption is forecast to recover in line with increasing real disposable income as the tax system is reaching its maturity. Investment is expected to remain the driving force of domestic demand.

The situation in the labour market improved in 1998, albeit marginally, and the unemployment rate resumed a slow downward path. The improvement in the labour market is expected to be supported in the remainder of the forecasting period by sustained activity and the announced plans for structural reform. Real wages decelerated significantly in 1998, reflecting the restrictive incomes policy in the public sector and the two–year wage agreement signed in May in the private sector, which provides for nominal wage increases on the basis of expected inflation. With real wages growing below labour productivity, unit labour costs are forecast to rise at a moderate pace in both years.

Slowing demand and labour costs assisted the containment of inflation in the post–devaluation period. On average consumer prices rose by 4.8% in 1998, down from 5.5% in 1997. In this context, the appreciation of the drachma and low international commodity prices played a significant role, while underlying inflation was also on a downward path during the second half of 1998. Slowing labour costs, lower indirect taxes and international commodity prices are expected to contribute to further disinflation during the forecasting period. Year–on–year CPI inflation reached 3.7% in January and February 1999, and is expected to decelerate further as from April when the impact of the last year devaluation will be fully absorbed.

TABLE 11: **Main features of country forecast – Greece**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	2.1	2.4	3.2	3.7	3.4	3.6
Priv. Cons.	2.7	1.9	2.5	1.8	2.0	2.0
GFCF	4.2	8.8	9.6	9.7	10.6	10.6
Exports (G&S)	0.5	3.0	5.3	9.2	5.7	6.5
Imports (G&S)	9.2	4.9	5.4	5.7	5.8	6.1
Inflation(a) (b)	–	7.9	5.4	4.5	2.1	1.9
Employment(a)	0.9	1.3	–0.5	0.2	0.7	0.8
Unemployment(c)	9.2	9.6	9.6	9.6	9.4	9.2
Gen. Gov. bal.(d)	–10.3	–7.5	–3.9	–2.4	–2.1	–1.9

(a) Annual percentage change, (b) Harmonised index of consumer prices, (c) % of labour force, (d) % of GDP.

Public finance posted an uninterrupted improvement since 1994. The March 1998 devaluation was accompanied by fiscal measures aimed at preventing any overshoot in the budgetary targets. Due to the successful implementation of the accompanying measures, the general government deficit was 2.4% of GDP in 1998 as targeted in the convergence programme. Government debt was reduced by 2.9 percentage points of GDP, mainly due to higher receipts from privatisation, following the implementation of the structural part of the accompanying measures.

For 1999, the deficit of the general government is forecast to be 2.1% of GDP. Risks emanating from current revenues and primary expenditure are relatively small. This is particularly true on the revenue side which benefits from growth dividend and the maturity of the fiscal system. The primary surplus is expected to reach 6.5% of GDP in 1999 and 2000 thus contributing to a further decline in the debt ratio in both years.

Spain

GDP accelerated in 1998, increasing by 3.8% compared with 3.5% in 1997. This acceleration took place mainly during the first half of the year, while in the second half activity decelerated slightly due to the international environment. Output growth was driven by domestic demand, especially private consumption and investment in equipment, while the external sector made a widening negative contribution.

The main impact of the unfavourable international setting is being felt through the external sector leading to a further deceleration of Spanish exports during 1999. As a result, GDP growth is expected to moderate to 3.3% in 1999. This scenario would lead to an accentuation of the trends previously observed: a healthy domestic demand and a growing negative contribution from the external sector. As domestic conditions are expected to remain growth–supportive, the foreseen gradual improvement of external demand from the end of 1999 would push output growth in 2000 towards an average rate of 3.5%.

TABLE 12: **Main features of country forecast – Spain**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	2.7	2.4	3.5	3.8	3.3	3.5
Priv. Cons.	1.6	2.0	3.1	3.8	3.7	3.5
GFCF	8.2	1.3	5.1	9.0	8.4	8.8
Exports (G&S)	10.0	10.6	14.8	7.8	6.0	7.7
Imports (G&S)	11.0	7.4	12.2	10.6	9.3	10.3
Inflation(a) (b)	–	3.6	1.9	1.8	1.8	1.9
Employment(a)	1.8	1.5	2.7	3.3	2.6	2.6
Unemployment(c)	22.9	22.2	20.8	18.8	17.3	15.8
Gen. Gov. bal.(d)	–7.1	–4.5	–2.6	–1.8	–1.6	–1.3

(a) Annual percentage change, (b) Harmonised index of consumer prices, (c) % of labour force, (d) % of GDP.

During 1999 domestic demand should remain strong, despite the worsening in the international situation, based on the strengthening of private consumption and investment in construction. In 1999 private consumption is to keep its previous strong pace mainly due to the personal income tax reform implemented since January this year, which will imply an increase in households' disposable income. Additionally, although more moderately than in 1998, job creation would still be significant. Regarding investment in construction, its dynamism would stem from higher public construction and the historically low interest rates which will boost residential construction. In contrast, investment in equipment is likely to slow down during 1999 due to the less dynamic external demand.

As for 2000, private consumption is expected to decelerate slightly in line with the moderation of households' incomes due to the fading away of the first impacts of the tax reform. As investment in construction is also likely to grow more moderately, domestic demand should be increasingly supported by the recovery in investment in equipment, thanks to the improvement in international economic prospects.

Employment rose briskly by 3.3% in 1998 and in 1999 is expected to decelerate in line with economic activity to 2.6%. These favourable developments can be partially explained by the labour market reforms implemented in recent years which have improved labour flexibility and have contributed to wage moderation. As a result, the still very high unemployment rate would continue decreasing to reach 17.3% in 1999 compared to 18.8% in 1998.

Strong economic activity in Spain is compatible with subdued inflation rates. HICP inflation was 1.8% in 1998. As energy and commodity prices are expected to remain low in 1999 and wage moderation is to continue, no inflationary pressures are foreseen in the near future. In addition, the large slack in labour resources and the deregulation measures which are expected to be implemented should also help to ease inflationary pressures.

The current account balance is expected to deteriorate gradually. Thus, in 1998, the surplus registered in 1997 shifted into a deficit and in 1999 and 2000 this deficit is expected to increase due to the growing trade deficit, which could not be offset by the surplus in the service balance.

The general government deficit fell significantly from 2.6% of GDP in 1997 to a lower–than–expected 1.8% in 1998 which is below the target of 2.1% (when the budget was presented the target was 2.5%), mainly a result of lower government primary expenditure owing to the restraint of government consumption.

In 1999, the general government deficit is expected to decline to 1.6% of GDP. The positive carry over effects in 1999 of the better–than–expected budgetary outcome in 1998 would be nearly cancelled out by the impact on the public finances from slower growth in 1999. There are also some uncertainties related to the final results for direct tax revenues due to the personal income tax reform. As a result, the deficit reduction in 1999 would rest mainly on the expected continuation in primary expenditure containment. In the context of the usual unchanged economic policy assumption, the deficit would fall to 1.3% of GDP in 2000 in the framework of a progressive recovery of economic activity.

In 1998, the debt–to–GDP ratio fell to 65.6%, and is expected to decline further to 64.7% in 1999 and to 62.4% in 2000. This reduction of the debt ratio would stem only from the gradual improvement foreseen in the primary surplus. Although the implicit interest rate of the debt would tend to decrease, the expected deceleration of economic activity along with a moderate inflation would also reduce nominal GDP growth, leading to a slight debt increasing ”snow–ball effect”.

France

The deterioration in the world economy slowed the pace of recovery. The visible signs of this were the contraction of foreign trade and the slowdown in stockbuilding against a background of a deteriorating production outlook in manufacturing. There was a marked decline in exports under the twin impact of the slowdown in worldwide demand and a decline in competitiveness.

Nevertheless, the recovery that was first discernible in 1997 continued in 1998 as domestic demand became much stronger, thereby permitting aggregate GDP growth of 3.2% and a healthy employment situation which allowed the jobless rate to be trimmed back by more than one percentage point between mid–1997 and the end of 1998.

TABLE 13: **Main features of country forecast – France**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	2.1	1.6	2.3	3.2	2.3	2.7
Priv. Cons.	1.7	2.0	0.9	3.7	2.8	2.8
GFCF	2.5	–0.5	0.2	4.1	4.1	4.1
Exports (G&S)	6.3	5.2	12.1	6.3	2.9	4.8
Imports (G&S)	5.1	3.0	7.7	8.0	4.2	5.4
Inflation(a) (b)	–	2.1	1.3	0.7	0.6	1.1
Employment (a)	1.0	0.2	0.2	1.3	1.1	1.0
Unemployment(c)	11.7	12.4	12.4	11.9	11.5	11.0
Gen. Gov. bal.(d)	–4.9	–4.1	–3.0	–2.9	–2.4	–2.0

(a) Annual percentage change, (b) Harmonised index of consumer prices
(c) % of labour force, (d) % of GDP.

The other feature of the current recovery is low inflation. This fell again, to 0.3% on a year–on–year basis by December 1998.

Economic activity is likely to have slackened temporarily at the turn of the year. This slowdown came sufficiently late for its effect on annual growth in 1998 to be negligible, although it is likely to have a marked impact on growth in 1999. The contribution of foreign trade to GDP growth will still be negative in 1999. Private consumption looks set for sustained progress, although slowing down compared with 1998’s exceptional rate of growth. High levels of purchasing power and consumer confidence should be maintained in 1999. The rise in average wages per head is expected to slacken only slightly. At the same time, the pace of job creation is likely to remain sustained, notably in the construction and service industries and especially in the non–market sector. In sum, the gains in the purchasing power of total wages and salaries observed in 1998 should continue in 1999 and 2000.

Housing investment, which was already staging a revival at the end of 1998, should continue its upward trend in 1999 (+5.0%): demand for new houses is still very high and activity has intensified, equalling its 1990 peak.

Business behaviour is less certain. Despite the continuing recovery in the financial position of enterprises, business investment in plant and machinery is likely to be halved in 1999 (+4.2%) owing to the erosion of demand expectations. The current time lag before the impact on investment is felt appears to be shorter than during the slowdown in 1995 and 1996. An upward adjustment in demand expectations, which seems to be taking place at the beginning of 1999, could pave the way for a resurgence in manufacturing investment starting in the spring. Business investment in building and construction, which started to improve in 1998, should speed up over the coming quarters.

Against this background, CPI inflation should remain in check, holding steady at an annual average of around 0.5% in 1999, before rising slightly in 2000. Compared with imported disinflation, there is no discernible wage pressure despite the downward trend in unemployment.

In 1998 the general government deficit was reduced to 2.9% of GDP, slightly below the initial target of 3%. Revenues were higher than originally forecast and very tight rein was kept on central government expenditure. However, substantial overspending was recorded for expenditure on sickness insurance.

In 1999 the deficit is currently estimated to fall to 2.4% of GDP, primarily as a result of continued restraint in public spending. There are mainly two major risks to this trend. First, low inflation could exert a brake on revenues in nominal terms. Second, the forecast is based on the assumption that the overspending on health will not be repeated. The Government has made changes to certain taxes (the most important one the removal over a five–year period of wages from the basis of assessment for business tax) the overall impact of which should slightly reduce the aggregate tax burden. The slowdown in activity should have a relatively small impact on government accounts owing to the nature of the French tax system (the receipts from certain key taxes such as personal income tax and corporation tax are collected one year after the underlying economic activity has taken place) and, in particular, to the structure of growth.

In 2000 the government deficit is forecast to fall to 2.0% of GDP under the no policy change assumption.

While still below 60%, the debt ratio is likely to continue to rise in 1998 and 1999. The debt ratio is expected to start falling from 2000 onwards.

Ireland

The economy looks to have surpassed expectations once again in 1998, with real GDP estimated to have increased by almost 12%. The pace of expansion is projected to slow only moderately over the period to 2000, as the components of domestic demand in particular continue to grow strongly.

The growth of private consumption is expected to moderate only slightly to about 7½% in 1999 as household disposable incomes continue to be buoyed by rising compensation per head, tax cuts, further growth in employment and reduced mortgage interest payments. Consumption growth is expected to be 7% in 2000. Investment growth is expected to slow a little over the forecast period. At the same time the growth in public consumption should be restrained by the Government's intention to reduce the growth of current government expenditure.

TABLE 14: **Main features of country forecast – Ireland**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	11.8	8.3	10.6	11.9	9.3	8.6
Priv. Cons.	4.1	6.1	6.3	8.5	7.5	7.0
GFCF	10.9	13.6	10.9	11.7	11.5	9.0
Exports (G&S)	19.6	11.8	16.9	20.2	14.7	13.6
Imports (G&S)	14.9	11.1	14.7	18.0	15.0	13.7
Inflation(a) (b)	–	2.2	1.2	2.1	1.6	2.4
Employment(a)	5.1	3.9	3.2	6.1	4.9	3.8
Unemployment(c)	12.3	11.6	9.8	7.8	6.0	4.7
Gen. Gov. bal.(d)	–2.1	–0.3	1.1	2.3	2.5	3.1

(a) Annual percentage change, (b) Harmonised index of consumer prices, (c) % of labour force, (d) % of GDP.

The substantial fall in interest rates in the last quarter of 1998 combined with tax cuts amounting to 1% of GDP and additional expenditure commitments in the 1999 budget should sustain the growth in domestic demand over the forecast period. The 1999 budget also allows for a further IEP 350 million (about ½% of GDP) of tax cuts in 2000 which should also sustain demand.

Exporters are expected to continue to make gains in market share in line with the experience throughout the 1990s. The continued strength of domestic demand in 1999 is, meanwhile, expected to sustain the growth of imports, thereby further reducing the external contribution to growth. While the merchandise trade balance nevertheless continues to remain in substantial surplus, both the services and the net factor incomes balances are expected to decline, resulting in a gradual reduction of the current account surplus over the forecast period.

CPI inflation peaked at 3.2% year–on–year in August 1998 and has been on a steady downward trend since then. For 1998 as a whole the figure was 2.4%. Wage developments, meanwhile, have been in the opposite direction: +5.8% in the year to September 1998 for industrial workers, +12.5% in construction and +4.9% in the public sector in the year to June 1998. With the extreme openness of the economy and generally low international inflation there is little prospect of externally driven inflation over the forecast period. This should restrain consumer price increases. However, the signs of overheating in the labour market are expected to worsen and wage increases are therefore expected to rise throughout the period of the forecast, with compensation per head expected to be rising by over 7% in 2000.

Employment growth should remain strong in both 1999 and 2000 but the decline in unemployment is expected to remain lower than the rise in employment as participation continues its long–term rise and inward migration continues.

The combination of continued strong revenue growth in line with the overall economy and more limited growth in expenditure should see the budget surplus increase in both 1999 and 2000. The surplus should reach about 3% of GDP in 2000 with the debt ratio falling to about 35% of GDP.

Italy

Unlike other European countries, economic growth in Italy is expected to improve slightly in 1999, after the lower–than–expected outcome of 1998. Real GDP growth is expected to strengthen moderately, from 1.4% in 1998 to 1.6% this year, and to increase to above 2% in 2000. Hence, the significant difference in growth between Italy and other countries of the euro zone is assumed to narrow gradually during the forecasting period.

TABLE 15: **Main features of country forecast – Italy**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	2.9	0.7	1.5	1.4	1.6	2.3
Priv. Cons.	1.4	1.2	2.4	1.9	1.8	2.3
GFCF	7.1	0.4	0.6	3.5	2.9	5.8
Exports (G&S)	12.0	–0.6	6.5	1.3	1.0	4.5
Imports (G&S)	9.6	–1.7	11.9	6.1	1.3	5.8
Inflation(a) (b)	–	4.0	1.9	2.0	1.5	1.6
Employment(a)	–0.3	0.0	–0.2	0.4	0.3	0.5
Unemployment(c)	11.9	12.0	12.1	12.2	12.2	11.9
Gen. Gov. bal.(d)	–7.7	–6.6	–2.7	–2.7	–2.3	–2.1

(a) Annual percentage change, (b) Harmonised index of consumer prices, (c) % of labour force, (d) % of GDP.

In 1999 lower interest rates should help sustain domestic demand, which should continue to grow, net of stocks, at a rate close to 2%. However, a marked destocking after the huge inventory build–up recorded in 1998 will prevent total domestic demand from growing faster. On the other hand, the contribution of external trade, though remaining negative, is expected to cease to impose a severe constraint on GDP growth. In 2000 economic growth is foreseen to be supported both by domestic demand and improving exports.

Private consumption in 1999 is expected to maintain broadly the same pace as in 1998 (just below 2%). In the context of a further fall in inflation, higher real disposable income is expected to support households' consumption. A more pronounced acceleration is expected to take place in 2000. The declining trend in the households' saving ratio is expected to continue, although at a markedly slower pace than observed between 1996 and 1998.

Total investment is expected to decelerate slightly in 1999, on account of a marked slowdown of investment in equipment. Indeed, the recent decline in the level of capacity utilisation in the manufacturing sector and the fall in business confidence are likely to restrain investment initiatives in the short term. Later in the year, however, fixed capital formation should recover, thanks to improving demand prospects and the announced changes in the tax treatment of reinvested profits. On the other hand, investment in construction, which remained considerably depressed in the last few years, should restart, helped by the incentives for housing restructuring and by the ongoing recovery of public investment. The recovery of total investment is expected to consolidate in 2000.

Export growth is foreseen to decelerate further in 1999, in line with the expected evolution of world demand. In 2000, the expected improvement in the international environment should allow a less subdued export performance. Import growth is expected to decelerate in 1999, as the exceptional circumstances which have boosted imports in 1997–98 (car incentives, restocking, international price developments) will fade out. A visible acceleration is expected in 2000, driven by stronger domestic demand. The trade balance is likely to remain above 3% of GDP during the period under consideration.

Employment is projected to improve gradually during the forecast period. Notwithstanding the slow pace of the economic recovery, employment is expected to benefit – as already happened in 1998 – from higher flexibility in the labour market and from the various initiatives aimed at reducing labour costs in the depressed areas.

Inflation is expected to remain subdued in 1999 in line with the expected evolution in other euro–zone countries. Low import prices, moderate output growth (leaving a negative output gap) and continuing wage moderation should allow a decline of CPI inflation to below 1.5% this year. Notwithstanding a slight acceleration in 2000, inflation is unlikely to exceed 2% throughout the forecasting period.

As for public finances, the general government deficit is estimated at 2.3% of GDP this year. The primary surplus is likely to deteriorate slightly and to be well below the government's target of 5.5%. Most of the slippage in the primary surplus is accounted for by lower–than–expected growth (the government assumption for growth in 1999 was 2.5%). On the other hand, interest payments, which were set at 7.5% of GDP in the government projections, are likely to decline more rapidly, thereby limiting the overshooting of the deficit target. Total revenues are projected to decrease slightly as a percentage of GDP, in line with the objective of reducing the fiscal burden, while total expenditure net of interest payments is expected to remain broadly unchanged as a percentage of GDP. However, some re–balancing in favour of capital expenditure is expected. As far as 2000 is concerned, a no policy–change scenario is assumed, which does not take into account the corrective measures announced but not specified in the Stability programme. Nonetheless, the deficit is assumed to decrease further to 2.1% of GDP, mainly as a a result of lower interest payments. The debt ratio is expected to continue to decline slightly over the forecast period, to reach 112.6% of GDP in the year 2000.

Luxembourg

According to initial estimates, real GDP grew by 5.7% in 1998 as compared with 3.7% in 1997. This strong growth was driven by particularly buoyant private consumption (up 3.8%, as against 2.8% the previous year), by investment and by exports, which dipped only very slightly in comparison with the previous year. The main engine of growth was market services, where value added is thought to have grown by nearly 5.3% (6.7% in financial services), but industry did not mark time either, with 3.7% growth, although metal processing suffered a very marked slowdown in the course of the year. The construction industry also performed well (up 5.4%). This very strong growth brought about a sharp rise in employment (4.4%). Most of the jobs created (two thirds in 1998, as against an average of nearly 75% in previous years) were taken up by frontier workers, the number of whom rose by over 10%. However, the growth in jobs held by residents, at nearly 2%, was much higher than in previous years. The result has been a fall in unemployment, for the first time since the end of the 1980s. Along with neighbouring countries, inflation was particularly low, with the consumer price index creeping up by a mere 1% for the year as a whole, as compared with 1.4% in 1997.

As in most other Member States, growth is expected to decelerate quite appreciably in Luxembourg in 1999 under the impact of the deteriorating international climate, falling to around 3¼%. The forecast is for the growth in exports to slow sharply, particularly exports of goods, which should grow by just under 4%.

Investment is also expected to increase much more slowly than last year, a trend which would, however, hold back the growth of imports. Growth should pick up again in the year 2000 as exports and, to a lesser extent, investment stage a recovery. Employment will follow this overall trend: it should grow more slowly this year, albeit still at around 2%, far outstripping the European average. Employment growth should pick up again in 2000 to around 3%. Unemployment could level off in absolute terms and even decline slightly

In 1998 the public finance situation remained particularly sound, with general government recording as in previous years a substantial surplus (some 2.1% of GDP). Public debt rose slightly but remained at a very low level (6.7% of

TABLE 16: **Main features of country forecast – Luxembourg**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	3.8	3.0	3.7	5.7	3.2	4.1
Priv. Cons.	2.4	1.9	2.8	3.8	2.5	3.0
GFCF	3.5	–1.7	8.0	9.7	3.0	4.2
Exports (G&S)	4.4	2.3	4.6	8.1	5.6	5.9
Imports (G&S)	3.8	1.0	5.2	8.5	5.0	5.4
Inflation(a) (b)	–	1.2	1.4	1.0	0.8	1.2
Employment(a)	2.5	2.9	3.1	4.4	2.1	3.0
Unemployment(c)	2.9	3.0	2.8	2.8	2.7	2.5
Gen. Gov. bal.(d)	1.8	2.8	2.9	2.1	1.5	1.4

(a) Annual percentage change, (b) Harmonised index of consumer prices, (c) % of labour force, (d) % of GDP.

GDP, as against 6.4% in 1997). The persistence of fairly brisk growth in 1999 and 2000 should enable the public authorities to continue to maintain a particularly favourable financial situation.

Netherlands

Dutch gross domestic product grew by 3.7% in real terms in 1998, the highest rate of the decade. Even more than in the preceding years, growth was driven by domestic demand and in particular by private consumption, which proved to be extremely buoyant, growing by almost 4.4% in real terms, the highest figure since 1976. The main determinants of such buoyancy were, as in the preceding years, the rapid increase in employment, the large reduction in taxes and social contributions achieved during the last parliament, and probably the improvement in the asset situation of households, linked to the sharp rise in the stock exchange and house prices. In addition, wage increases accelerated appreciably, and since mid–1997 are again running at more than an annualised 3%. However, investment grew by only 4% compared with 6.8% in 1997. Imports, reflecting the buoyancy of domestic demand, increased significantly while exports suffered from the deterioration in the international environment, and slowed markedly over the year.

Growth will probably not exceed 2¼% in 1999 since exports are not likely to grow by more than 4%. Similarly, investment should increase by a bare 1¼%, reflecting the deterioration in enterprises confidence. Private consumption will continue to underpin growth, as a result of the same factors which have contributed to its buoyancy over recent years. Real GDP growth is likely to pick up speed again in 2000 as a result in particular to a recovery of exports; real GDP growth could thus reach 2¾%.

TABLE 17: **Main features of country forecast – Netherlands**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	2.3	3.1	3.6	3.7	2.3	2.7
Priv. Cons.	2.0	2.7	3.0	4.4	3.6	2.8
GFCF	4.8	5.4	6.8	4.0	1.2	2.0
Exports (G&S)	6.7	5.2	6.7	6.4	3.8	5.4
Imports (G&S)	7.5	5.3	7.1	7.6	4.5	5.5
Inflation(a) (b)	–	1.4	1.9	1.8	1.6	1.6
Employment(a)	1.4	2.0	2.6	2.5	1.3	1.5
Unemployment(c)	6.9	6.3	5.2	4.0	3.6	3.3
Gen. Gov. bal.(d)	–4.0	–2.0	–0.9	–0.9	–1.6	–1.3

(a) Annual percentage change, (b) Harmonised index of consumer prices, (c) % of labour force, (d) % of GDP.

Inflation is unlikely to accelerate significantly over the forecast period, at between 1½% and 2%, higher than the figures for the neighbouring countries.

As in the preceding years the strong growth in 1998 was reflected in a rapid increase in employment, a full–time equivalent of almost 2.5%. Unemployment therefore went on falling, from 6.3% of the labour force in 1996 to 4.0% in 1998. The slowdown in activity in 1999 will be reflected in the lower growth of employment, some 1¼%. Unemployment is therefore likely to go on falling, but at a slower pace. In 2000 employment can be expected to start rising and unemployment to start coming down faster again.

In 1998, despite the buoyancy of the economy, which was reflected in substantially higher tax revenues, the general government deficit remained stable at 0.9% of GDP, as in 1997; public debt continued to decline, from 71.2% of GDP to 67.7%. The economic slowdown is likely to be reflected in 1999 by a deterioration in the public deficit, which is estimated to rise to 1.6% of GDP, before coming down again to around 1.3% next year, in response to the pick–up in growth. The fall in the debt ratio is likely to continue at a slower pace and it should come down to 67% of GDP this year and 65.5% in 2000.

Austria

Following output growth of more than 3% in 1998, economic activity in Austria is expected to increase less strongly in 1999 under the influence of slowing growth in the economies of main trading partners, in particular Germany. The observed deterioration of business confidence and of other short–term indicators such as industrial production and merchandise exports are clear evidence of a slowdown in the Austrian economy during the winter half–year 1998/99. In accordance with the assumed gradual improvement in the international environment, output growth should, however, regain momentum in the second half of 1999. Annual growth for 2000 is thus estimated at some 2¾ %.

TABLE 18: **Main features of country forecast – Austria**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	1.7	2.0	2.5	3.3	2.3	2.7
Priv. Cons.	2.9	2.0	0.7	2.1	2.2	2.2
GFCF	1.2	2.5	2.8	5.9	4.4	4.4
Exports (G & S)	6.5	6.9	10.1	7.2	4.8	6.4
Imports (G & S)	7.0	6.3	8.7	6.5	5.4	6.3
Inflation(a) (b)	–	1.8	1.2	0.8	1.0	1.2
Employment(a)	0.2	–0.5	0.4	0.8	0.6	0.7
Unemployment(c)	3.9	4.3	4.4	4.4	4.3	4.2
Gen. Gov. bal.(d)	–5.1	–3.7	–1.9	–2.1	–2.0	–1.9

(a) Annual percentage change, (b) Harmonised index of consumer prices, (c) % of labour force, (d) % of GDP.

Domestic demand is expected to remain robust throughout the forecast period. Supply side conditions – in particular unit labour costs and the user cost of capital – will, in general, remain favourable, bolstering private investment. Private consumption should continue to be strong – despite a further increase in the households saving ratio from its historically low level in 1997 – underpinned by higher employment and accelerating wage increases. The contribution of net exports to GDP growth, which was one of the main driving forces during the upswing in 1997/98 will, under the assumed international economic scenario, turn negative in 1999 and reverse in 2000.

The trade balance will continue to improve in 1999 with the deterioration in volume terms being more than offset by gains in the terms of trade. This, in conjunction with a marked recovery of tourism net income should contribute to a further improvement in the current account from the rather high deficit of around 2% of GDP witnessed in the recent past.

As elsewhere in Europe, thanks also to low import prices, there are no inflationary pressures in Austria at present. However, in view of an acceleration in pay rises and the closing of the output gap consumer prices are expected to edge up from 1999 onwards. Mainly due to relatively high productivity increases, unit labour costs will rise only moderately. The significant improvement in relative unit labour costs between 1996 and 1998 will thus be largely safeguarded during the forecast period.

In line with the relatively favourable outlook for growth, employment is expected to increase, although somewhat less than in 1998. The forecast assumes that the recent increase in the labour force participation rate, which has been partially due to policy measures – such as a *de facto* shortening of parental leave – will level off during the projection period. As a consequence, and in contrast to previous years, during the forecast period employment gains should be more directly translated into a decline in the unemployment rate.

Consolidation of government finances paused in 1998, but is expected to resume in 1999/2000 with a gentle decrease in the government deficit for both years. This forecast incorporates the assumption that recent changes in family assistance will burden government finances by 0.2% of GDP in 1999 and by 0.4% of GDP in 2000. The reform of family assistance will be part and parcel of a more general tax reform that will take effect in 2000. The additional measures, which at the time when the forecast was prepared were not known in detail and have thus not been incorporated, are supposed to provide a net tax relief of the order ½ of a percent of GDP. Unless compensated by expenditure savings this would imply a significant increase in the budget deficit in 2000.

Portugal

Following the acceleration of economic activity in 1997 and 1998, a slowdown in GDP growth seems likely in 1999. The main factors behind this development are the abating of the effects of Expo98 and a decline in business confidence associated with the less favourable international environment. These dampening effects will, however, be partially offset by the impact of lower interest rates. As a result, a weaker contribution of domestic demand and less buoyant export growth could restrain GDP growth to somewhat above 3%. A slight rebound is expected in 2000 when a recovery of external demand will lead to a less negative contribution from the external balance to GDP growth.

Due to the pick–up of the economy and according to the revised employment survey, improvements in the labour market were significant in 1998. Employment increased by 2.5% and the unemployment rate decreased to an annual average of 5.0%. Employment gains were particularly strong in sectors with low productivity increases such as public and private services. A slight decrease in the unemployment rate is forecast both in 1999 and 2000 and, as a consequence, the labour market may become increasingly tight.

Private consumption is forecast to grow at a steady albeit decelerating rate in 1999 and 2000 supported by a sustained increase in real disposable income, a continued good labour market situation and lower interest rates. Investment should decelerate somewhat in 1999 but should remain high throughout the forecast period. Construction investment is even expected to accelerate slightly but equipment investment could decelerate due to a slowdown of machinery investment after the marked increase during the previous four years. Thanks to high productivity gains in the tradables sector the increase in unit labour costs in this sector will remain moderate allowing exports to rise faster than market growth. The current account deficit is foreseen to increase slightly to 2½% of GDP in 1999 and above 3% of GDP in 2000.

TABLE 19: **Main features of country forecast – Portugal**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	2.9	3.2	3.1	4.0	3.2	3.3
Priv. Cons.	1.6	2.5	2.9	4.3	3.9	3.7
GFCF	4.8	5.7	11.3	8.7	6.7	7.1
Exports (G & S)	9.1	10.2	8.4	9.5	5.7	7.0
Imports(G & S)	7.8	7.5	11.7	11.5	8.0	7.9
Inflation(a) (b)	–	2.9	1.9	2.2	2.1	1.9
Employment(a)	–0.7	0.7	1.9	2.5	0.8	0.5
Unemployment(c)	7.3	7.3	6.8	4.9	4.7	4.6
Gen. Gov. bal.(d)	–5.7	–3.3	–2.5	–2.3	–2.0	–1.7

(a) Annual percentage change, (b) Harmonised index of consumer prices, (c) % of labour force, break in series in 1998, (d) % of GDP.

Headline inflation accelerated in 1998, due particularly to some special factors like the increase in some food prices and strong demand of some goods and services owing to the Expo98. In the forecast period the decrease of import prices and the slowdown of economic activity are likely to dampen inflationary pressures but this could be counteracted by wage pressures. The abating of the special factors prevailing in 1998 should nevertheless lead to a deceleration of inflation in both 1999 and 2000.

In 1998, the general government deficit decreased slightly to 2.3% of GDP. Owing also to asset–related measures, notably privatisation, the debt ratio came down by almost 4 percentage points to some 58% of GDP. The general government deficit in 1999 is expected to decline to 2.0% of GDP, mainly as a result of decreasing interest payments and high output growth, and a further decrease is foreseen in 2000. Similarly, the government debt ratio is expected to continue its downward trend in both 1999 and 2000.

Finland

In 1998, GDP rose by an estimated 5.3% (ESA79). Booming private consumption gave a strong boost to GDP growth. Domestic demand accounted for most of overall growth. The development of Finnish economy became greatly polarised since the second half of 1998 as industrial output and net exports decelerated sharply whereas domestic demand remained strong.

The structure of exports also changed markedly, with exports of electronics and especially telecommunications equipment growing rapidly compared to deceleration in almost all other sectors.

The weakened outlook in export markets is expected to lead to a deceleration in economic growth in 1999. The positive development of high–technology exports are expected to partially offset the negative impact of the external sector. The polarisation of economic development, now led by domestic demand, is expected to continue in 1999. Households' confidence has remained at a high level. Private consumption is estimated to have risen by 5% in 1998.

Consumers have financed the increases in consumption by borrowing and reduced savings. However, for 1999 private consumption is expected to decelerate, because of lower wage growth and because the sharp fall in the saving ratio which occurred in 1998 is unlikely to be repeated. Growth of public consumption, on the other hand, has remained subdued.

TABLE 20: **Main features of country forecast – Finland**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	4.0	4.1	5.6	5.3	3.7	3.9
Priv. Cons.	4.2	3.4	2.2	5.1	3.8	2.8
GFCF	11.9	8.7	14.2	9.8	6.7	6.6
Exports (G&S)	8.7	6.1	14.2	6.6	4.0	6.1
Imports (G&S)	7.9	6.3	11.4	8.1	5.6	6.6
Inflation(a) (b)	–	1.1	1.2	1.4	1.0	1.1
Employment(a)	1.7	1.2	2.5	2.4	1.7	2.0
Unemployment(c)	15.6	14.8	12.7	11.4	10.1	9.4
Gen. Gov. bal.(d)	–4.6	–3.1	–1.2	1.0	2.5	2.7

(a) Annual percentage change, (b) Harmonised index of consumer prices, (c) % of labour force, (d) % of GDP.

Good business profitability and the financial position of firms set positive preconditions for investment. Construction activity is expected to remain robust in the forecasting period albeit less buoyant than in 1998.

Declining import prices contributed to a deceleration of consumer price inflation in the course of 1998, leading to an average of 1.4 %. The average inflation rate is expected to fall further in the forecasting period.

The rate of employment creation decelerated somewhat in 1998. Most new jobs are being created in the private services sector. The unemployment rate, which averaged 12.7% in 1997, declined to 11.4 % in 1998.

Employment growth is expected to decelerate despite the shifting focus in GDP growth from the capital–intensive export industry to the more labour–intensive construction and services sectors.

The general government surplus is expected to be close to 2.5% of GDP in the forecasting period. Government consumption is assumed to remain subdued, due to the savings measures.

Sweden

GDP growth is estimated to have been somewhat above trend, at 2.9%, in 1998. It was sustained totally by domestic demand. Despite strong growth, the economy was generally thought to have been operating below potential throughout 1998 and inflationary pressures were weak. Moreover, the international economic environment and, consequently, the prospects for world growth worsened. It was this overall environment that resulted in successive cuts in the repo rate to 3.15% in February 1999 from 4.35% at the start of 1998. The indications are that GDP growth in 1999 will be lower than in 1998 at 2.2%. Growth in 2000 should be above trend and is projected to accelerate to 2.7%.

Private consumption in 1999 is expected to grow well, at 2.7%. It will be supported by several factors. Real wages should rise moderately. Employment is forecast to grow

TABLE 21: **Main features of country forecast – Sweden**

	1995	1996	1997	1998	1999	2000
Real GDP(a)	3.9	1.3	1.8	2.9	2.2	2.7
Priv. Cons.	0.8	1.3	2.0	2.6	2.7	2.9
GFCF	12.4	3.7	–4.8	9.6	4.6	6.0
Exports (G&S)	12.9	6.1	12.8	7.3	4.3	5.6
Imports (G&S)	10.2	3.7	11.7	11.0	4.9	6.6
Inflation(a) (b)	–	0.8	1.8	1.0	0.6	0.9
Employment(a)	1.5	–0.5	–1.1	1.4	0.9	0.7
Unemployment(c)	8.8	9.6	9.9	8.2	7.8	7.6
Gen. Gov. bal.(d)	–7.0	–3.5	–0.7	2.0	0.3	1.8

(a) Annual percentage change, (b) Harmonised index of consumer prices, (c) % of labour force, (d) % of GDP.

though at reduced rates from 1998. A temporary tax cut will augment disposable income. Consumer confidence with respect to consumers' own finances is currently high. That still implies a significant rise in the saving ratio though to perhaps a more normal level. In 2000 private consumption growth, at 2.9%, is projected to be a little higher than in 1999.

Fixed investment in 1999 should grow well and this will result from strong construction investment supported by strong rises in new dwellings built and by retail and wholesale construction. Equipment investment will grow more slowly. Investment growth is expected to accelerate in 2000. Construction investment growth will be strong as in 1999 and, in addition, equipment investment should grow more rapidly as the prospects for industry improve.

Strong growth of consumption and investment in 1999 will be partly offset by a negative contribution from stock–building.

Export growth will slow in 1999 to a little below the growth in Sweden's markets but import growth should also remained subdued as a result of lower stockbuilding and slower growth of equipment investment Export growth will recover in 2000 as export markets grow more rapidly but, offsetting this, imports are expected to grow strongly due to stronger growth in domestic demand.

Despite a temporary tax cut in 1999, the effects of restrained expenditure and falling interest costs on the debt should result in a surplus of 0.25% of GDP in the government finances**.** The surplus is expected to rise to 1.8% of GDP in 2000 as economic growth accelerates, interest payments fall further and the temporary tax cut in 1999 is reversed. Debt relative to GDP is expected to fall to 65% at the end of 2000.

Output is expected to remain below or close to potential over the next two years. Inflationary pressures will therefore remain weak. CPI inflation is expected to rise, in part because the recent falls in interest rates fall out of the calculation, but inflation should remain below 1% and that is also true on an HICP basis.

United Kingdom

GDP grew by 2.3% in 1998 and growth slowed down in the second half of the year.With prospects of slower growth and little sign of current and future threats to inflation, the Bank of England's Monetary Policy Committee reduced the repo rate from 7½% last October to 5½% in February.

TABLE 22: **Main features of country forecast – United Kingdom**

	1995	1996	1997	1998	1999	2000
Real GDP[(a)]	2.8	2.6	3.5	2.3	1.1	2.3
Priv. Cons.	1.7	3.6	4.2	2.6	2.2	2.5
GFCF	2.9	4.9	6.1	8.0	2.7	3.6
Exports (G&S)	9.5	7.5	8.4	2.7	2.5	5.4
Imports (G&S)	5.5	9.1	9.5	7.8	4.7	5.8
Inflation[(a) (b)]	–	2.5	1.8	1.5	1.5	1.5
Employment[(a)]	1.5	1.2	1.8	1.0	0.3	0.5
Unemployment[(c)]	8.7	8.2	7.0	6.3	6.5	6.6
Gen. Gov. bal.[(d)]	–5.7	–4.4	–1.9	0.6	–0.1	–0.1

(a) Annual percentage change, (b) Harmonised index of consumer prices, (c) % of labour force, (d) % of GDP.

The signs are that economic growth appeared weak, if not flat, around the turn of the year but there are encouraging signs. Manufacturing output rose a little in January. Industrial surveys do not reveal buoyancy but they do suggest an improvement in prospects. Consumer confidence is rising. Unemployment remains low. However, export volumes are flat.

GDP is not expected to fall but it will remain weak in the first half of 1999. This is due to the lagged effect of sterling's strength as well as continued low growth in the UK's export markets. Growth is expected to recover to a little under trend – estimated to be around 2¼ to 2½% a year – in the second half of the year as the positive effects of improved monetary conditions are felt and the depressing effects of sterling's strength on net exports fades**.** GDP growth is projected to average 1.1% in 1999. Growth should pick up in the first half of 2000 as the full effects of the improved monetary policy conditions are felt and the negative effects of sterling's appreciation finally fade away. GDP growth in 2000 is projected at 2.3%.

Consumers' expenditure is projected to grow moderately, by 2.2%, in 1999. This is due to modest real rises in wages, continuing employment growth albeit small, and rises in (net) interest income as cuts in short term interest rates reduce the cost of servicing mortgage debt. Nevertheless the saving ratio is forecast to rise in 1999 to a more normal level from 1998's exceptionally low figure. Consumers' expenditure should also continue to grow moderately in 2000 for similar reasons.

Fixed investment is expected to grow in 1999 but at a reduced rate from 1998. Construction investment should be supported by dwellings investment and by the government's plans to increase its share of investment in GDP. However, equipment investment growth will weaken as subdued profits restrain expenditure. Growth of fixed investment should pick up in 2000 as equipment investment recovers a little. Government investment will continue to grow strongly. Growth in consumption and fixed investment will be partly offset by a decline in stockbuilding in 1999 following a rapid build–up in 1998. In 2000 this will not be a drag on growth.

Growth of exports of goods and services is expected to revive during the course of 1999 as the effects of sterling's past strength disappears, but net exports in 1999 as a whole are forecast to decline as growth in UK markets falls and import growth remains strong. In 2000, the UK's export markets, and hence exports, will grow more strongly as the world outlook improves.

Despite weak growth in 1999, employment is expected to grow slightly though the unemployment rate is expected to edge up gradually. The public finances are projected to be close to balance in 1999 following 1998's surplus. The move from surplus, in part, results from the effects of faster growth in planned expenditure and falls in revenue from company taxes. The effects of the 1999 budget are expected to be broadly neutral in 1999 and 2000. The public finances are expected to remain close to balance in 2000 when the debt to GDP ratio is forecast to fall to 46%.

During 1999 and 2000, inflationary pressures should remain subdued as output moves, initially, below productive potential. Unit labour cost growth is expected to fall a little despite the introduction of a minimum wage, as labour market pressures fall. The government's 2½% target for RPIX inflation is projected to be met in 1999 and 2000 and HICP inflation should be around 1½%.

15 April 1999