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# European Economic Forecast

## Summer 2019 (Interim)

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European Commission  
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## European Economic Forecast Summer 2019 (Interim)



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## GROWTH CLOUDED BY EXTERNAL FACTORS

*At mid-year, the European economy shows resilience in domestic demand, but export-oriented activity remains subdued. The recent escalation in trade tensions and the corresponding uncertainty is depressing already weak global activity, particularly in the manufacturing sector. Recent hard and soft data confirm that the ‘soft patch’ in manufacturing and trade that began in 2018 has extended well into 2019. In the quarters ahead, economic activity in the euro area will depend on the way three divergences play out: the resilience of the services sector and the labour market in the face of manufacturing weakness; robust growth in Central and Eastern Europe, which contrasts with the slowdown in Germany and Italy; and the missing pass-through from higher wages to core inflation.*

*Economic growth in the euro area exceeded expectations in the first quarter of the year, driven by domestic demand. However, the economy’s strong performance was flattered by a number of temporary factors such as stockpiling in the UK ahead of the original Brexit date, the mild winter and the rebound in car sales. Their positive impulse is set to unwind in the second quarter and likely weigh on activity. Further ahead, the rebound anticipated later in the year now looks weaker, as the global manufacturing cycle has yet to bottom out and the outlook for trade and investment continues to be clouded by protectionism and uncertainty. The labour market remains the bright spot in the euro area outlook. But here too the outlook is increasingly challenged by the protracted weakness in manufacturing and external demand, which may eventually spill over to services and dampen job creation, wage growth and private consumption.*

*Overall, the euro area economy is set to continue expanding this year and next, with annual growth forecast to slow from 1.9% in 2018 to 1.2% in 2019 (1.4% in the EU) before firming up at 1.4% in 2020 (1.6% in the EU) helped by a higher number of working days. The relative stability in the annual growth outlook compared to the spring, however, masks a weakening in near-term growth prospects that fully offsets the positive growth surprise in the first quarter. While the annual GDP growth forecast for this year remains unchanged, the lower growth projected in the second half of the year could undermine the continued resilience of the services sector and the expectation of robust domestic demand as the key growth driver of the euro area economy. Despite vigorous wage growth, subdued demand and high uncertainty keep firms from raising prices. As oil prices are also assumed to remain subdued, euro area headline inflation has been revised slightly lower, to 1.3% in both forecast years.*

*The euro area growth outlook is thus subject to risks that are skewed to the downside and appear even more interconnected than before at this fragile juncture in the global economy. Any further escalation of trade tensions and an increase in policy uncertainty, could prolong the current downturn in global trade and manufacturing and trigger a sharp shift in global risk sentiment and rapid tightening of global financial conditions. This adds to concerns about the medium-term outlook in China and the recent intensification of geopolitical tensions in the Middle East. On the domestic side, given the purely technical assumption of status quo in terms of trading relations between the EU27 and the UK, a “no deal” Brexit remains a major source of risk.*

Table 1:

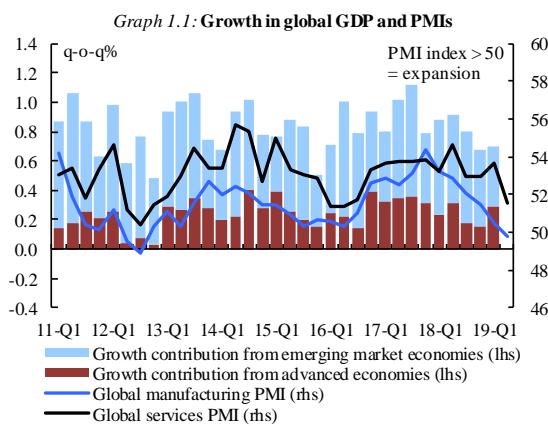
### Overview - the Summer 2019 interim forecast

	Real GDP growth						Inflation					
	Summer 2019 interim forecast			Spring 2019 forecast			Summer 2019 interim forecast			Spring 2019 forecast		
	2018	2019	2020	2018	2019	2020	2018	2019	2020	2018	2019	2020
<b>Euro area</b>	1.9	1.2	1.4	1.9	1.2	1.5	1.8	1.3	1.3	1.8	1.4	1.4
<b>EU27</b>	2.1	1.4	1.6	2.1	1.4	1.7	1.8	1.5	1.5	1.8	1.5	1.6
<b>EU28</b>	2.0	1.4	1.6	2.0	1.4	1.6	1.9	1.5	1.6	1.9	1.6	1.7

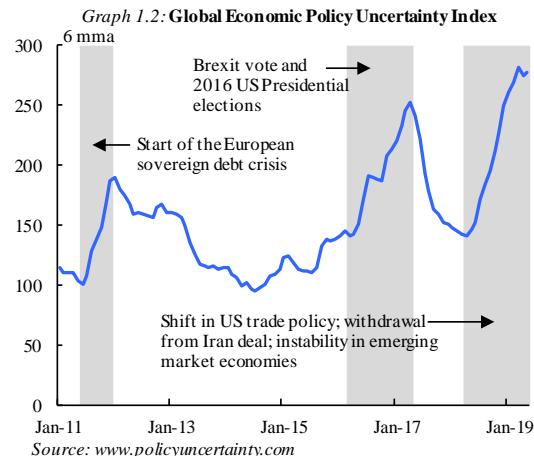
# 1. EURO AREA AND EU OUTLOOK

## 1.1. WEAKER GLOBAL GROWTH AMID HIGH US-CHINA ECONOMIC TENSIONS AND ELEVATED POLICY UNCERTAINTY

Global GDP growth in the first quarter of 2019 continued at the same pace as in the last quarter of 2018 despite significant headwinds to economic activity in a number of major economies. However, headline figures masked a divergence in the growth performance of countries and regions as well as a persistent broad-based weakness in global manufacturing and trade. Growth in advanced economies and China surprised to the upside in 2019-Q1 on the back of stronger-than-expected contributions from net exports. Conversely, activity softened in a number of big emerging markets. GDP contracted in Mexico, Brazil and South Africa, while growth was weaker than expected in Russia and India. Furthermore, available data suggest that global industrial output and trade activity remained sluggish in early 2019. High-frequency indicators continue to point to a weakening of global growth momentum in the second quarter of 2019 (see Graph 1.1).



The re-escalation of the economic confrontation between the US and China, together with elevated uncertainty (see Graph 1.2), are dampening already fragile business sentiment and have pushed global PMIs further down to multi-year lows (See Graph 1.1).



The outlook for global growth outside the EU has weakened since the spring. Strong labour markets in advanced economies, easier monetary policy from a number of major central banks, and the macroeconomic stimulus in China are all expected to support global economic activity going forward. However, these supportive factors look insufficient to contain the negative effects of the recently intensified trade tensions between the US and China as well as the broader political uncertainty globally (see Graph 1.2). Thus, global GDP growth (excluding the EU) is projected to slow from 3.8% in 2018 to 3.4% in 2019, before picking up moderately to 3.6% in 2020 (see Table 1.1).

The growth outlook for the US and China has deteriorated slightly since the spring. Nevertheless, GDP growth in the US is expected to remain above potential in 2019, underpinned by easier financing conditions (see Section 1.2), remaining tailwinds from fiscal stimulus, and robust consumer

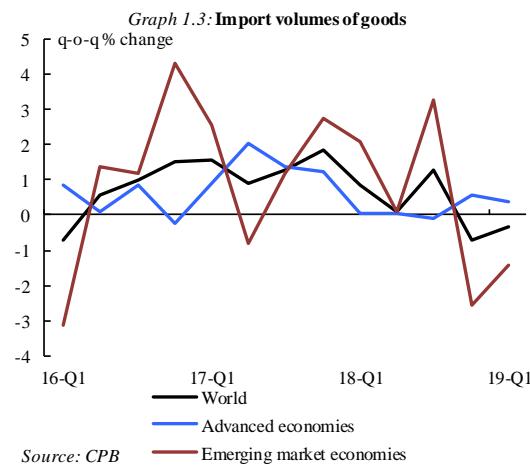
**Table 1.1:**  
**International environment**

(Annual percentage change)	Summer 2019 interim forecast			Spring 2019 forecast		
	2015	2016	2017	2018	2019	2020
<b>Real GDP growth</b>						
World (excl.EU)	3.5	3.4	3.9	3.8	3.4	3.6
<b>Merchandise trade volumes</b>						
World (excl.EU) exports of goods and services	1.5	1.8	5.4	4.0	1.8	2.8
World (excl.EU) imports of goods and services	0.4	1.0	6.0	4.7	1.6	3.1

sentiment. By 2020, US GDP growth is set to gradually slow toward potential as the growth impulse from sizeable tax cuts and higher government spending fades out. In China, growth is projected to only gradually weaken over the forecast horizon as the monetary and fiscal policy stimulus deployed is expected to help cushion most of the negative impact from the economic tensions with the US. Growth prospects in other emerging markets remain differentiated, but overall, benign global financing conditions should support a continued recovery in many of these countries, contributing positively to global growth. In 2020, a cyclical upswing in a number of countries recently affected by financial stress and other idiosyncratic headwinds (Turkey, South Africa, and countries in Latin America, the Middle East and North Africa) should particularly contribute to the expected uptick in global growth outside the EU.

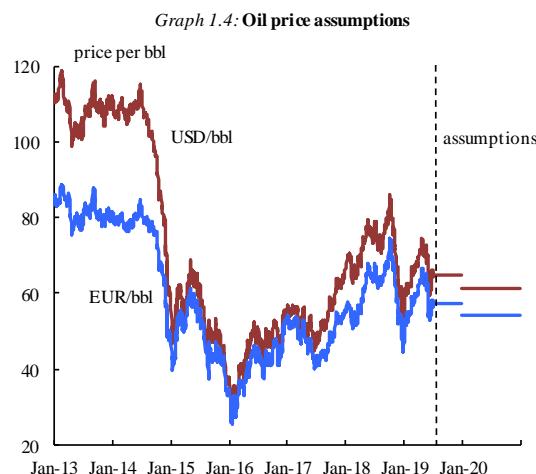
#### **Global trade outlook deteriorated sharply.**

Global goods' import volumes (outside the EU) contracted in 2018-Q4 and 2019-Q1 (see Graph 1.3). Following this weak start, world import growth outside the EU (goods and services) is expected to decelerate to 1.6% this year, the lowest rate since 2016 and significantly weaker than projected in the spring. The subdued outlook for trade activity in 2019 reflects the current trade tensions and the increase in the level of trade restrictions among G20 countries. It also underpins the weak underlying momentum in global industrial output, signs of weaker investment momentum and lower demand for capital goods. In this regard, the elasticity of import growth to GDP growth for countries outside the EU is set to be particularly low in 2019, driven by the observed softening of investment, the most trade-intensive demand component, and stagnating import growth in China. A more resilient global services sector, by contrast, is expected to boost trade and support GDP growth. As global activity bottoms out and assuming no further escalation of trade tensions, world import growth should rebound to 3.1% in 2020.



#### **Lower oil prices than expected in the spring.**

Oil prices have decreased to just over 60 USD/bbl in May 2019 amid growing uncertainties related to global growth and intensification of the US-China trade dispute. More recently, rising geopolitical tensions in the Middle East have pushed Brent oil prices again up above USD 65/bbl (see Graph 1.4). Nevertheless, the assumptions for Brent oil prices have been revised downwards, in line with futures markets, to an average of USD 64.7/bbl in 2019 and USD 61.5/bbl in 2020, down by 7% in 2019 and 9% in 2020 compared to the spring assumptions.



#### **1.2. FINANCIAL MARKETS ARE SWAYED BY RISKS AND EASIER MONETARY POLICY**

The mood in financial markets in the EU and abroad has been swinging between risk-aversion and the expectation of easier monetary policy. In May, uncertainty around the macroeconomic outlook and concerns about US trade policy and

geopolitical tensions temporarily weighed on equity prices and lifted the price of risk-free assets. More recently, major central banks have revisited their policy stances. Increased prospects of a prolonged period of easy monetary conditions, including lower interest rates, in particular in the US, together with supportive fiscal policies in major economic regions, recently led to some return of risk-taking, despite considerable global uncertainties and persistent vulnerabilities.

#### **Expectations of more accommodative monetary policy have increased again ...**

Muted inflationary pressures and increased uncertainties around the macroeconomic outlook have led major central banks in advanced economies to signal more clearly their readiness to support economic activity, if needed. While the US Federal Reserve has left its policy rates unchanged since December 2018, the Federal Open Market Committee indicated at its latest meeting in June its intention to act appropriately to support economic expansion. This has been interpreted by financial markets as a shift in the Fed's stance that opens the door to interest rate cuts ahead, with market-based interest expectations discounting as many as two interest rate cuts this year in the US.

The ECB Governing Council in June also clearly signalled its determination to act in case of adverse contingencies as well as its readiness to adjust all its policy instruments as necessary. The ECB Governing Council also extended its forward guidance on policy rates by several months, with key ECB interest rates now expected "to remain at their present levels at least through the first half of 2020". The ECB also disclosed the terms of the new series of quarterly Targeted Longer-Term Refinancing Operations (TLTRO III).<sup>(1)</sup> The TLTRO III operations are aimed at safeguarding favourable bank lending conditions and supporting access to financing, in particular for small and medium-sized enterprises.<sup>(2)</sup>

<sup>(1)</sup> Under the TLTRO III, euro area banks will have access to two-year loans offered on a quarterly basis between September 2019 and March 2021 by the Eurosystem.

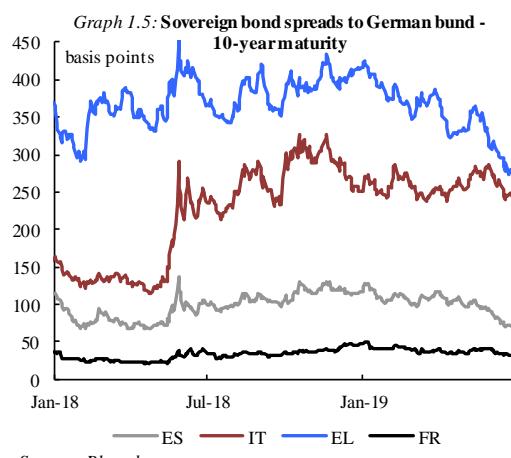
<sup>(2)</sup> Like the TLTRO II, the new series of operations feature built-in incentives on credit supply that can bring funding costs of euro area banks down to levels as low as the average interest rate on the deposit facility prevailing over the life of the operation plus 10 basis points.

#### **... and the euro has regained some strength.**

The euro has appreciated by close to 2% in nominal effective terms since the beginning of April. The euro has strengthened against the currencies of most of the euro area's major trading partners, with the exception of the Japanese yen and to a lesser extent, the Swiss franc. The euro appears to have benefited from rising risk aversion among investors globally in the context of mounting fears about the potential negative impact on the global economy from renewed trade tensions between the US and China. The euro's rise, however, has been relatively recent, as it had been broadly stable against the US dollar in April and May and only gained strength in recent weeks following the latest monetary policy meeting of the US Federal Reserve (see the technical assumption on exchange rates in Box 1 – Table 1).

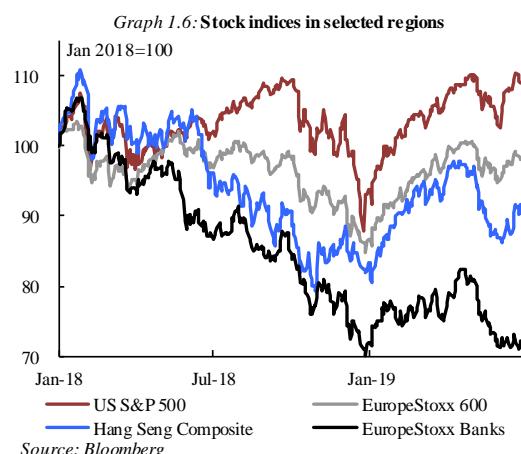
#### **Sovereign bond yields have fallen across the globe...**

The yields on 10-year German government bonds have been significantly negative since early May, reflecting increased uncertainty around the economic outlook, declining longer-term market inflation expectations, rising geopolitical and policy risks, as well as expectations of further accommodative monetary policy. In the US, the inversion of the yield curve for Treasuries has become more pronounced as markets are pricing in policy interest rate cuts in 2019 and 2020. The spread between German Bunds and most other euro area government bonds has narrowed amid a reassessment of risks by investors and rising expectations of greater monetary policy accommodation from the ECB (see Graph 1.5).



**...while global stock markets declined in May and recovered in June.**

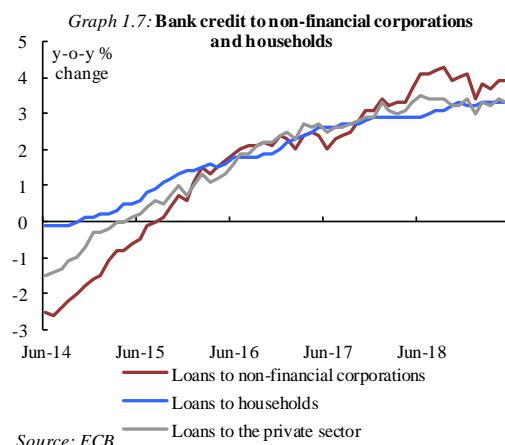
Global stock markets began heading downwards in late April as trade tensions renewed but recovered in most regions in June as central banks sent out more dovish signals (see Graph 1.6). In the EU, however, the banking sector underperformed significantly due to concerns about low profitability levels and the flattening yield curve. In Asia, Chinese stock markets underperformed global markets amid the escalation in trade tensions with the US and despite the measures taken by national fiscal and monetary authorities to cushion the impact of implemented or announced US tariff hikes. Conversely, the US's S&P 500 reached new all-time record highs. Corporate credit markets took their cue from equities, with EU and US corporate bond spreads widening in May and then narrowing in June.



**Bank lending and market funding continued to expand over the last couple of months.**

In May, loans to households and non-financial corporates continued increasing at a relatively steady pace of 3.3% and 3.9% respectively (see Graph 1.7). Meanwhile the cost of borrowing remained virtually unchanged for both households and non-financial corporations.

Regarding market funding, monthly net corporate bond issuance remained positive over the first months of this year (April is the latest data available). Net equity issuance was limited, however, reflecting the higher cost of equity compared to debt (the equity premium), and the effect of certain large share buy-back programmes.



Overall, the shift in the global monetary policy stance is expected to keep financing conditions favourable over the forecast horizon (see the technical assumption on yields in Box 1 - Table 1), and mitigates the risk of an abrupt rise in historically low yields. However, vulnerabilities remain given the prospect of ample bond issuance in the years ahead and stretched equity valuations, particularly in the US.

### 1.3. EURO AREA EXPANSION MODERATES AMID PERSISTING WEAKNESS IN MANUFACTURING AND TRADE

**Growth picked up at the start of the year supported by temporary factors...**

In mid-2019, the outlook for the European economy remains clouded by the persistence of high levels of policy uncertainty and the weakness of global trade. While survey readings have been broadly consistent with protracted weakness, quarterly growth in the first quarter strengthened to a rate not seen since the first half of last year. Given the role of temporary factors and the signals of weakness from recent indicators, however, this uptick in the first quarter is unlikely to suggest a turnaround.

In the first quarter of 2019, euro area GDP growth picked up for the second consecutive quarter, expanding by 0.4% (q-o-q), up from 0.2% in the previous quarter. In the EU, GDP expanded by 0.5%, higher than the 0.3% seen in 2018-Q4. In both areas, this represented the 24<sup>th</sup> consecutive quarter of expansion. In Germany, growth turned positive after two quarters of either contraction or stagnation, and Italy left the technical recession in which it had been over the second half of 2018.

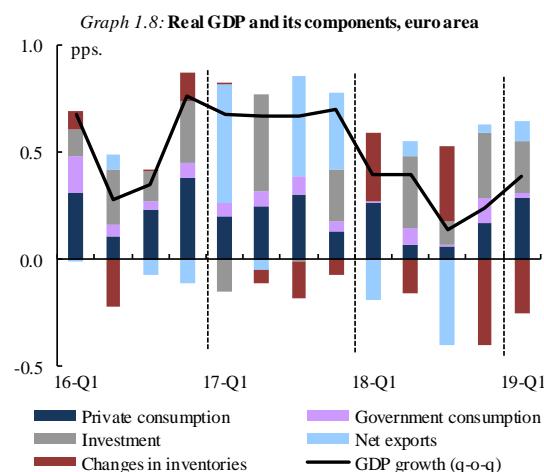
Quarter-on-quarter growth in the euro area was thus slightly above the spring forecast. There is, however, evidence that the stronger-than-expected outturn reflects a number of temporary or one-off factors. These included mild weather, which benefited construction activity particularly in Germany;<sup>(3)</sup> a rebound in euro area car sales following disruptions in the second half of 2018 related to new test procedures; and the substantial increase in goods exports to the United Kingdom, spurred by companies stockpiling in anticipation of the original Brexit date. Growth also benefited from fiscal policy measures, which boosted household disposable income in several Member States.

#### **... and driven by domestic demand.**

The GDP breakdown confirms the role of domestic demand, and in particular private consumption and investment, as a driving force of growth in 2019-Q1 (see Graph 1.8). The contribution of domestic demand (excluding changes in inventories) to quarterly growth, however, remained broadly unchanged due to a lower positive impulse from public consumption and non-construction investment. Net exports added moderately to growth (+0.1 pps.), despite a deceleration in exports, while the contribution from inventories was negative for the second consecutive quarter. In the EU, the contribution of net trade to growth turned negative (-0.2 pps.), driven by a substantial deterioration in the UK.

In line with continued labour market improvements, private consumption growth firmed to 0.5% in the euro area (from 0.3% in the previous quarter). The pick-up in private consumption was propelled by a surge in spending on durable goods, while consumption of non-durable goods, and services, remained largely unchanged. In contrast, public consumption growth slowed significantly, reflecting a moderation in France and, above all, a contraction in Germany.

<sup>(3)</sup> Where favourable conditions were reflected in a substantial fall of firms' assessment of the limiting impact of weather conditions on building activity.



Investment continued to grow faster than GDP for the fourth consecutive quarter. In the euro area, its expansion moderated somewhat (1.1% q-o-q, after 1.4% in 2018-Q4), while it firmed in the EU (to 1.3% from 1.1%). This was mainly driven by investment in construction. Non-construction investment continued increasing despite the weakness in the manufacturing sector, but growth slowed because of a sharp drop in Italy. Destocking subtracted 0.3 pps. from quarterly GDP growth, mainly as a result of significant destocking in Germany and Italy. This is reflected in a weakening of import growth (from 1.2% to 0.4%), which failed to outpace final aggregate demand.

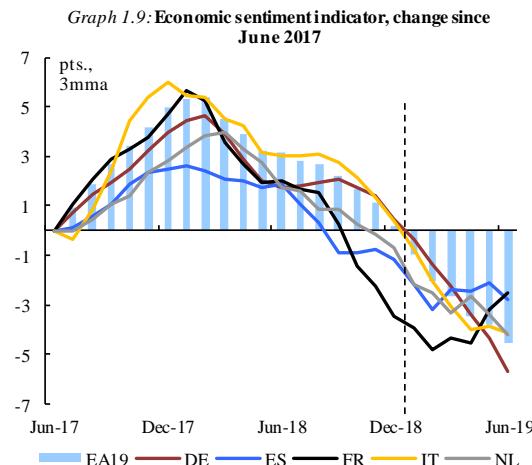
Export growth in the euro area halved in the first quarter (to 0.6% q-o-q from 1.2% in 2018-Q4), dragged down by a contraction service exports. Goods exports, by contrast, remained strong, increasing by 1.0%, as exceptionally strong sales to the UK (stockpiling) offset a fall in exports to China. All in all, extra-euro area exports of goods increased by about 0.6%, whereas intra-euro area goods exports rebounded to 1.1% (-0.6% in the prior quarter), its first expansion since the first half of 2018.

#### **Lacklustre performance in the second quarter...**

Incoming data on activity and sentiment provide evidence that the positive growth surprise in the first quarter may prove temporary and could be followed by renewed weakness in euro area activity in the second quarter of this year.

Recent survey indicators continue to hint at a protracted weakness in the manufacturing sector, with the services sector remaining relatively

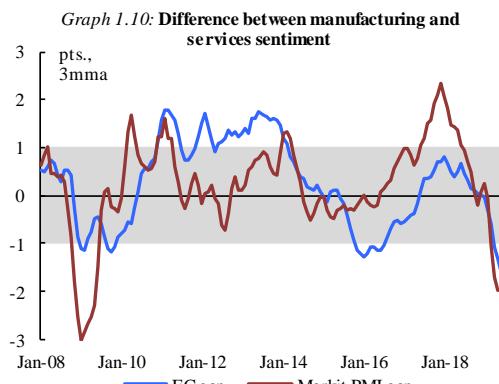
resilient. Both the Commission's Economic Sentiment Indicator (ESI) and the Eurozone Composite Output Purchasing Managers' Index (PMI) remained subdued in the second quarter, while the dichotomy between the services and the manufacturing sectors remains present.



The deterioration of the ESI (see Graph 1.9) was driven particularly by lower industrial confidence, which saw its most significant decrease in about eight years, largely reflecting a sharp drop in Germany. It now stands below its long-term average for the first time since autumn 2013. This is in contrast with services confidence, which has been broadly steady since the end of 2018. At present, the gap between sentiment in both sectors remains exceptionally large (see Graph 1.10).

#### ...and industrial output yet to bottom out...

Despite a strong rebound in January (+2.0%) and the ensuing robust figure for the first quarter (0.9% q-o-q), industrial output appears not to have bottomed out yet. Production was flat in February, and contracted again in both March and April, weighing on output in the second quarter.



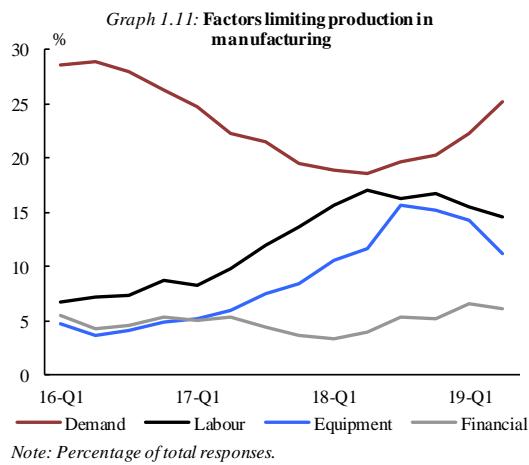
Note: Standardised starting in 2002. Shaded areas represent one standard deviation from the mean. A negative value signals lower sentiment in manufacturing compared to that in services.

Looking ahead, available high-frequency indicators are consistent with some moderation in private consumption expenditure, particularly on durable goods. While passenger car registrations geared up strongly in April and May, this follows a marked decline in the preceding month. At the same time, retail trade volumes declined in April, following a flat reading in March.

Business investment appears to have underperformed in 2019-Q2. While still above its long-term average, the capacity utilisation rate in manufacturing declined sharply in the second quarter to 82.8%, well below the post-crisis high recorded in 2018-Q1 (84.2%).

This lower intensity in the use of the available manufacturing capacity is particularly evident in Germany, where lack of demand is now the most stringent factor limiting production for the first time since early-2017, ahead of labour shortages. In the euro area as a whole, after being considerably below average, lack of demand is also increasingly mentioned as a limiting factor in business surveys (see Graph 1.11).

The Commission's Construction Confidence Indicator weakened in the second quarter, after reaching a historic high in January. This is particularly visible in employment expectations over the coming three months, which are now less positive. Construction output fell in April (-0.8%) for the second month in a row. Furthermore, the reversal of the exceptional weather-related increase in construction investment in the first quarter is set to dampen activity in the second.

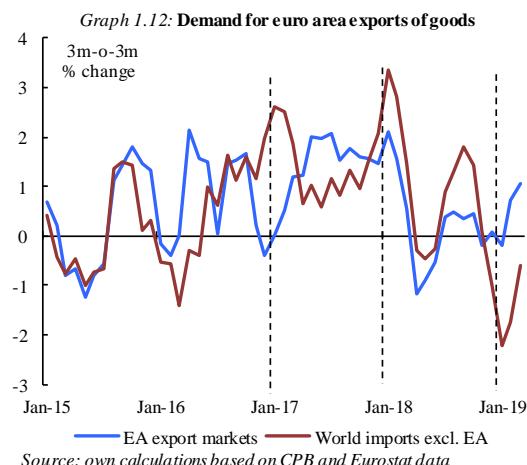


Profitability measures also do not suggest a brightening outlook. Profit margins (measured as the ratio of nominal gross operating surplus to GDP) remained weak in the first quarter, with its annual growth rate matching its average over 2018 (which was about half of what was recorded in the previous year).

#### ...and weak export prospects...

Exports are expected to remain subdued given the broad-based weakness in global demand and the continuing soft patch in global manufacturing.<sup>(4)</sup> The cooling in export prospects is also signalled by the assessment of export order books in the Commission's manufacturing survey, which continued on a downward trend. It is now at its lowest in almost three years.

Contrary to what had been the case in the three first quarters of 2018, the geographical orientation of extra-euro area exports appears to have been more supportive at the beginning of 2019 (led by the UK, Turkey and China). While world import demand (excluding the euro area) fell by 0.6% (q-o-q), euro area export markets<sup>(5)</sup> expanded by 1.1%, a gap that had already taken shape in the last quarter of 2018 (see Graph 1.12), resulting in a weaker drag on growth than might have been expected otherwise.



#### ...suggesting subdued momentum in the near term.

Looking through the temporary factors that supported growth in the first quarter, the underlying cyclical momentum remains weak, as the growth soft patch appears to have extended well into 2019. On balance, the outlook for the coming quarters is expected to be dragged by some payback in the second quarter and the persisting weakness in manufacturing, which appears to have spilled over to economic expectations more generally. Were the weaker momentum to persist and to affect the labour market more generally, the current resilience of the services sector would eventually be tested as well. Evidence from employment expectations from business surveys already suggest the possibility of negative spillovers, particularly in manufacturing. Against this backdrop, the fading of lingering uncertainties and the gradual firming of the momentum in manufacturing and trade remains key for the moderate pick-up in euro area activity expected towards the end of the year.

#### Domestic demand is holding up for now...

The domestic fundamentals of the European economy continue to hold firm, with domestic growth drivers set to remain the backbone of economic growth over the forecast horizon. GDP growth is set to benefit from a favourable policy mix, with a continuously accommodative monetary policy stance and an expansionary fiscal policy in a number of Member States.<sup>(6)</sup> Furthermore, diminishing deleveraging needs from both corporates and households, on average, are

<sup>(4)</sup> New industrial orders from non-euro area countries fell in the first quarter for the first time since 2016.

<sup>(5)</sup> Based on data from CPB World Trade Monitor on the volume of goods imports by trading partners weighted by their respective share in euro area exports.

<sup>(6)</sup> The contribution of direct taxes, contributions and net transfers to disposable income growth in the euro area is thus set to turn positive for the first time in nine years.

expected to create further room for increased private expenditure.

Looking ahead, private consumption is expected to remain solid, supported by above-average consumer confidence as well as a rise in net wealth (due to rising house prices and stock market gains), and growing real incomes. The slower expected pace of employment creation compared to last year (see Section 1.4) should be compensated, in part, by rising wages and a somewhat smaller increase in consumer prices this year than expected in the spring forecast (see Section 1.5).

Investment is expected to continue its expansion but to lose some impetus. The weak trade momentum, persisting policy uncertainty and the decline in profit margins<sup>(7)</sup> - as higher wage costs are yet to be matched by increased productivity growth – are set to weigh increasingly on non-construction investment. Weak trade and policy uncertainty can be expected to continue to exert a larger drag in more export-oriented and capital-intensive sectors and in Member States with a higher degree of global value chain integration.<sup>(8)</sup> Business investment may also be dampened by the recent decline in capacity utilisation in manufacturing, which reduced the stringency of supply constraints to some degree, as well as by the end of targeted fiscal incentives in some Member States.

Despite some moderation in the near term, construction investment is expected to remain dynamic, supported by an extended period of favourable financing conditions and brightening income prospects, as well as rising real house prices. At the same time, the outlook for the sector is set to be constrained by labour shortages amid increased evidence of difficulties in recruiting skilled labour, as well as by demographic factors weighing on the demand for housing.

<sup>(7)</sup> See ECB (2019). ‘The role of profits in domestic price pressures’. *Eurosystem staff macroeconomic projections*, Box 3, pp. 12-14. June.

<sup>(8)</sup> The European economy is highly integrated in global value chains – about 70% of exports are linked to forward and backward supply chains, compared to between 40-45% in the Americas and Asia. On growth spillovers from the US and China to European economies see R. Huidrom, N. Jovanovic, C. Mulas-Granados, L. Papi, F. Raei, E. Stavrev, and P. Wingender (2019). ‘Trade tensions, global value chains, and spillovers: insights for Europe’. International Monetary Fund. European Department 19/10.

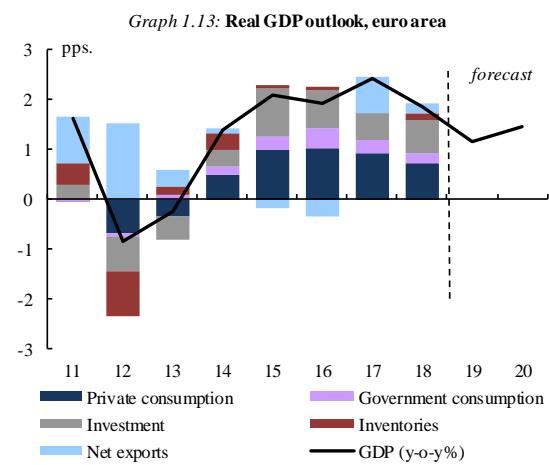
### ...despite a weaker outlook for global growth and persisting uncertainty.

Assuming no further escalation in trade tensions and gradually more supportive global demand, euro area export growth is expected to slow down this year before bouncing back somewhat in 2020. However, persisting trade policy uncertainty and the exposure of European exports to the global investment and manufacturing cycles pose increased challenges and limit the scope for a major rebound in exports over the forecast horizon.

As in previous forecasts, projections for 2019 and 2020 are based on a purely technical assumption of status quo in terms of trading relations between the EU27 and the UK. This is for forecasting purposes only and has no bearing on future negotiations between the EU and the UK.

### Annual growth forecasts shored up by the first-quarter growth surprise.

Overall, euro area GDP growth is forecast to slow from 1.9% in 2018 to 1.2% in 2019, before picking up to 1.4% in 2020, on the back of a moderate firming in global growth and a higher number of working days in some Member States (see Graph 1.8). All in all, the GDP growth forecast for this year remains unchanged but the forecast for the euro area next year has been marginally revised down compared to the spring forecast.



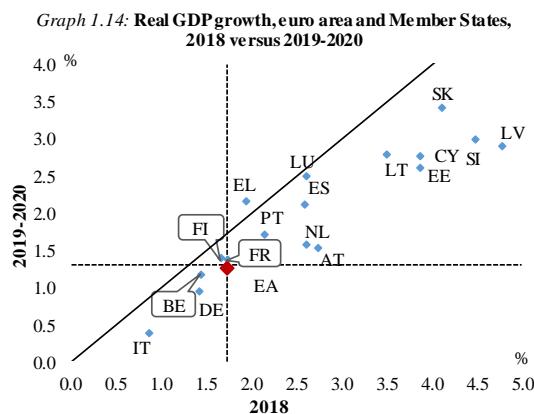
This stability, however, masks an important reassessment in near-term growth prospects, as the positive growth surprise in the first quarter fully offsets a projected weakening of the growth outlook for the remainder of 2019. While leaving annual GDP forecasts unchanged, this downgrade of the near-term momentum exposes a host of

negative risks that are likely to test the resilience of both domestic demand and the services sector (see Section 1.6).

All Member States are expected to grow over the forecast horizon. Those that have grown faster than average in 2018 should continue to outperform, with Greece the only euro area country to see growth accelerating (see Graph 1.14).

#### Persisting weakness in manufacturing and trade may test the resilience of Central and Eastern Europe.

Most countries in Central and Eastern Europe continue to enjoy very strong growth momentum despite their economic proximity to the euro area Member States at the centre of the current soft patch (Germany, Italy). The inflow of structural funds and robust domestic demand buoyed by strong labour markets have so far acted as effective cushions against a slow-down in their main trading partners. However, there is a clear risk that this decoupling may not be sustainable for much longer if the current weakness in manufacturing and trade persists.



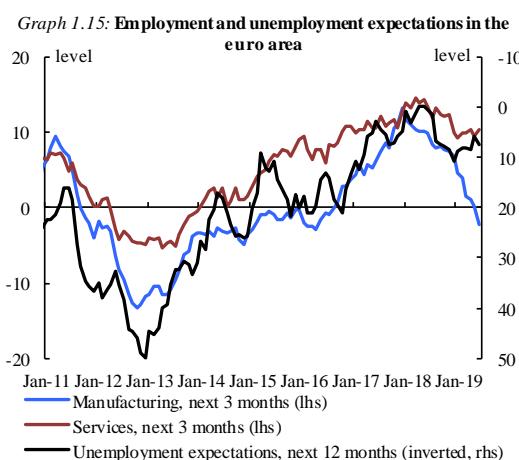
#### 1.4. LABOUR MARKET CONDITIONS SET TO CONTINUE IMPROVING SLIGHTLY

The labour market situation in the euro area continued to improve in the first months of 2019, with employment increasing and unemployment declining further. In the first quarter, the number of persons employed increased at an unchanged rate of 0.3% compared with the previous quarter and by 1.2% compared to the first quarter of last year to a new all-time high of 159.5 million. The increase in the number of employed persons was

broad-based across sectors and included manufacturing, where employment growth increased in the first quarter to 0.5% as compared to the preceding quarter, completing a period of 16 quarters of uninterrupted employment growth. In the first quarter of 2019, the number of hours worked in the euro area increased by 0.3% and reached the highest level since the second quarter of 2008. In May 2019, the unemployment rate stood at 7.5%, which was lower than in December 2018 (0.4 pps.) and one year before (0.8 pps.). In the first quarter of 2019, the job vacancy rate in the euro area remained stable at its all-time high of 2.3% (data available since 2006).

While the improvements in the labour market situation were broadly shared across countries unemployment rates still vary significantly. Differences also remain in terms of the tightness of labour markets. The rather high labour shortage in manufacturing and in the services sector in some Member States (e.g. Germany), as perceived by respondents in the Commission surveys, eased slightly in the second quarter of 2019 (April survey).

Forward-looking labour market indicators have moderated further up to mid-2019. Survey indicators of firms' recruitment intentions remain consistent with continued but slower job creation in the near term because gloomier employment expectations have so far largely been confined to manufacturing (see Graph 1.15).



According to the Commission's surveys, employment expectations deteriorated between December 2018 and June 2019 in manufacturing (8.8 pts. to 2.2 with the long-term average (LTA) at 7.6) and, to a lesser extent, in the retail sector (0.4 to 2.4, LTA at 2.8), but slightly improved in

services (+0.6 to 10.4, LTA at 6.2) and construction sectors (+0.7 to 11.2, LTA at 9.1). The decoupling between manufacturing and services could serve as an explanation of developments in consumers' unemployment fears, which have even slightly declined in the last six months (from 10.8 to 7.5, LTA at 26.7).

Overall, the more moderate pace of economic growth in the euro area is expected to reduce further improvements in the labour market situation but not to stop them. Moreover, these improvements are further put at risk by the continued weakness in manufacturing. Should this weakness start affecting services more strongly, this could weigh on projected benign labour market conditions.

### 1.5. ENERGY PRICES DRIVE INFLATION LOWER

Despite rising wages and relatively robust private consumption, inflation has remained subdued so far. As the strong base effects from energy price inflation gradually bottomed out, headline inflation moderated again in May and June from earlier this year. This diminishing impact from energy price inflation is expected to continue for most of 2019.

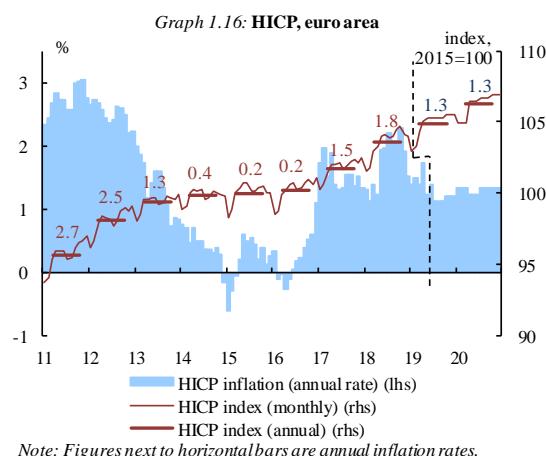
HICP inflation in the euro area averaged 1.4% in the first quarter of 2019. Influenced by the timing of the Easter holidays, inflation in April increased to 1.7% on the back of strong services inflation (package holidays and accommodation in particular). Inflation dropped again to 1.2% in May and June (flash estimate). At 1.4%, headline HICP inflation in the second quarter of 2019 came in line with the spring forecast.

#### No discernible increase in core inflation despite strong wage growth.

The core inflation rate (all items excluding energy and unprocessed food) increased from 1.0% in May to 1.2% in June, matching the 2018 average, and remaining subdued with no discernible trend. Favourable labour market developments remain supportive of solid wage growth, which in turn should add to domestic price pressures, especially those of services. Compensation per employee growth remains relatively high compared to its historical average, standing at 2.2% in 2019-Q1, and is increasing much more than the traditionally closely correlated services inflation. As evidenced by the latest data on profit margins, firms seem to

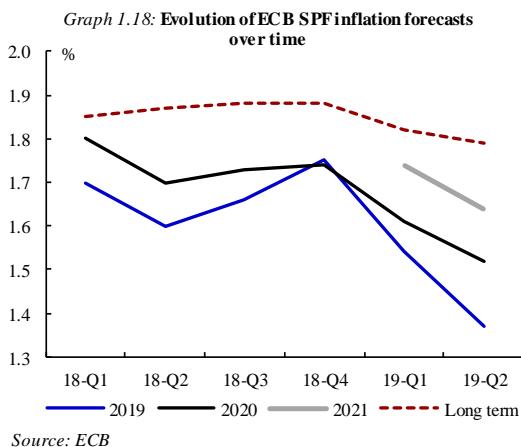
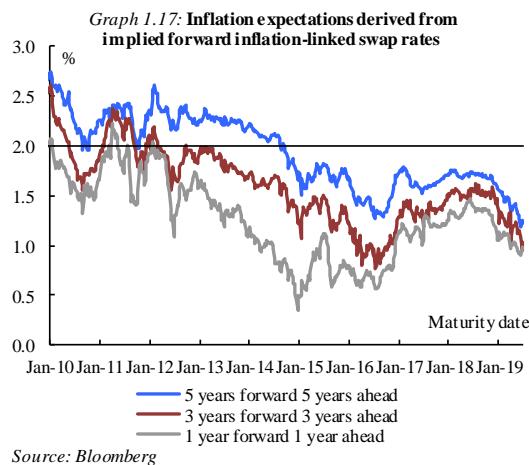
be absorbing higher wages at the cost of their profits rather than increasing prices given persistently subdued demand and rising uncertainties. Also, pipeline price pressures in the manufacturing sector remain low, as evidenced by low non-energy industrial goods inflation and also by falling industrial producer prices.

Overall, given also the lower technical assumptions about oil prices, the forecast for headline inflation in the euro area is revised down to 1.3% in both years, which is 0.1 pps. lower compared to the spring forecast (see Graph 1.16).



The decline in inflation expectations is a source of concern. Market-based measures of inflation expectations have continued to trend lower in all maturity spectrums since mid-2018. At the cut-off date of this forecast, inflation-linked swap rates stood at around 0.8% at the one-year forward one-year ahead horizon and at 1.0% at the three-year forward three-year-ahead horizon. On a longer horizon, the widely watched five-year forward five-year-ahead indicator suggests inflation of 1.2% (see Graph 1.17), reaching the lowest levels registered since mid-2016.

The ECB's April 2019 Survey of Professional Forecasters (SPF) includes inflation forecast means of 1.4% in 2019, 1.5% in 2020 and 1.6% in 2021 (down by 0.1 pps. for each of those years). On the other hand, longer-term inflation expectations remained at 1.8% (see Graph 1.18).



## 1.6. DOWNSIDE RISKS IN THE NEAR TERM HAVE INCREASED AGAIN

Risks to the global outlook are highly interconnected and skewed to the downside...

In an environment of highly interconnected risks, the re-escalation of US-China tensions increased the likelihood of other downside risks materialising. An extended economic confrontation between the US and China, together with the elevated uncertainty around US trade policy, could prolong the current downturn in global trade and manufacturing with possible negative spillovers to other regions and sectors (notably services), which would risk derailing the expected firming-up of the global economy. In addition, fears about further intensification of US-China tensions could trigger a sharp shift in global risk sentiment at a time when valuations appear stretched across many asset classes and leverage in the financial and non-financial system remain elevated. This could lead to a rapid

tightening of global financial conditions, with knock on effects on some emerging markets where financial vulnerabilities related to high debt remain. In China, medium-term downside risks have also increased as the stimulus measures put in place to counteract US tariffs could exacerbate financial risk and leverage. Risks related to the recent intensification of geopolitical tensions in the Middle East have also increased, with a potential to significantly lift oil prices.

...with risks related to policy in the EU...

On the domestic side, Brexit remains a major source of uncertainty, with a no deal Brexit being one of the key negative risks to the outlook. If the latter were to materialise, it would lead to a more disruptive impact on the EU-UK trade relationship and on economic activity in Europe (and the UK), than currently envisaged under the purely technical assumption of status quo in terms of trading relations between the EU27 and the UK.

...and surrounding the economic momentum.

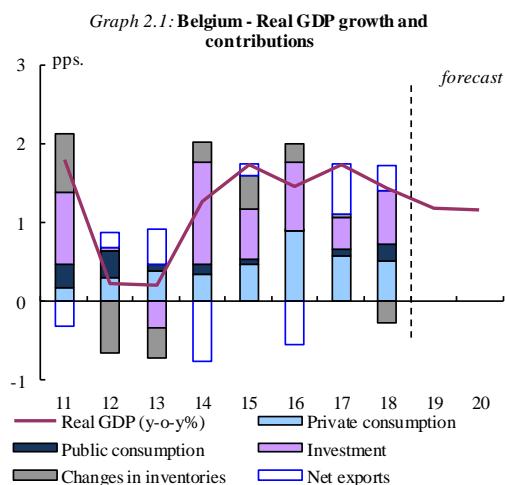
Significant risks surround some of the key assumptions regarding the near-term growth drivers and economic momentum in the euro area. Persisting policy uncertainty, protracted weakness in manufacturing and still depressed business confidence could eventually translate into a gradual worsening of labour market conditions and undermine the resilience of the domestic economy as a driver of growth in the euro area. Finally, there is a risk that the robust growth momentum across Central and Eastern Europe (driven by solid growth in domestic demand and the inflow of structural funds) may not be sustained for much longer if the current weakness in manufacturing and trade continues to weigh on their main trading partners in the euro area.

## 2. PROSPECTS BY MEMBER STATES

### EURO AREA

#### 2.1. BELGIUM

GDP growth eased in 2018 to 1.4%, from 1.7% in 2017, mainly due to slower private consumption and private investment growth, while net exports made a positive contribution to growth. Although growth remained robust in the first quarter of this year, economic sentiment has deteriorated in most sectors since January, with survey data consistently pointing to weaker order books and expectations of slower employment growth.



Domestic demand is forecast to drive economic growth in Belgium in 2019 and 2020. Private consumption is expected to strengthen gradually as disposable income growth is supported by sound labour market conditions and personal income tax cuts. Following a marked rebound in 2018, investment growth is set to slow down. Household investment is projected to peak in 2019 and weaken thereafter. Despite favourable financing conditions and sound profitability, business investment growth is expected to slacken gradually, reflecting lower confidence and reduced order books. Public investment, by contrast, is expected to ease markedly in 2019 and then pick up again slightly in 2020, in line with the electoral cycle.

Despite sustained domestic demand, GDP growth is forecast to ease to 1.2% in 2019 and 2020. The contribution of net exports to GDP growth is expected to be neutral in 2019 and turn negative in 2020. While the projected slowdown in world

trade is likely to weigh on exports, imports should find increasing support from the strength of domestic demand. Downside risks are related to weaker-than-expected growth in Belgium's main trading partners, which could negatively affect investment and net exports.

Headline inflation remained high at 2.3% in 2018, driven by rising fossil fuel and wholesale electricity prices and higher food prices. Headline inflation is expected to ease to 1.6% in 2019 and 2020, reflecting lower increases in food prices and the assumption of lower oil prices. Collective wage increases, decreasing profit margins and weak competition in some business and professional services sectors are expected to contribute to rising core inflation in 2019 and 2020. The inflation gap between Belgium and the euro area is projected to decrease to 0.3 pps. in 2019 and remain stable in 2020.

#### 2.2. GERMANY

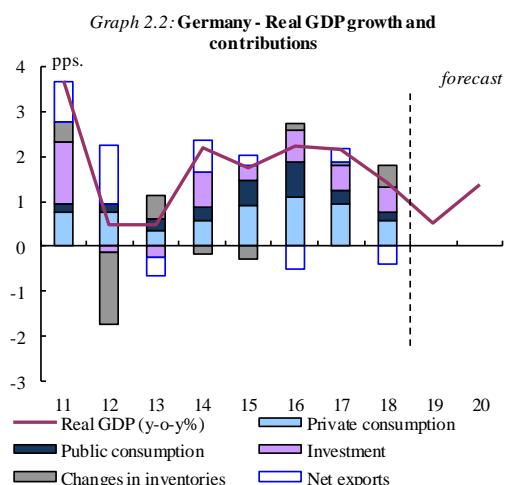
Germany's real GDP growth rebounded tangibly from a near-recession in late 2018 to 0.4% in the first quarter of 2019. The normalisation of automotive sales had an appreciable effect across the board in exports, investment, private consumption and inventories. Private consumption growth was also stimulated by fiscal measures which had a positive impact on retail sales and consumer services. Export growth was broad-based geographically and was partly boosted by frontloading of deliveries to the UK in anticipation of Brexit. While import growth was solid, overall net exports contributed positively to GDP growth.

Construction investment increased further, reflecting strong housing demand and infrastructure needs and the benefit of favourable weather conditions. Although capacity utilisation levels decreased, equipment investment growth strengthened in a number of asset types including not only vehicles but also electronics and machinery.

Prospects for the rest of the year, however, look less bright and the forecast for quarterly real GDP growth has been revised down compared to spring. In particular, the second quarter seems to have seen a decline in economic activity. Part of this reflects a statistical 'payback' for the strength of

growth in the first quarter while the cooling of overall economic sentiment has deepened in recent months. Survey data point to a deterioration in foreign demand and a weakness in order inflows and industrial activity. The automotive sector in particular will likely continue to grapple with the deterioration in the external environment, as well as lingering uncertainty about trade policy and consumer preferences. German exporters are also concerned that any escalation in protectionism would likely weigh on business confidence across the globe and thus dampen global investment demand.

On the other hand, domestic demand is proving resilient and should support a recovery in the second half of the year. With unemployment at a record low and solid wage growth, private consumption should continue to sustain growth. Public consumption growth is expected to resume later in the year.



Overall, real GDP is now forecast to increase by 0.5% in 2019 and by 1.4% 2020, slightly less than expected in the spring. The stronger-than-anticipated outcome in the first quarter explains the unchanged annual figure for this year, despite the downward revisions for the rest of the year. Economic activity will receive an additional boost of almost 0.4% in 2020, thanks to a significant working day effect. Risks are tilted to the downside and stem mainly from the deteriorating external environment, but also domestic, as the negative sentiment in the manufacturing sector could spill over to the currently resilient services sector, as well as to consumer confidence.

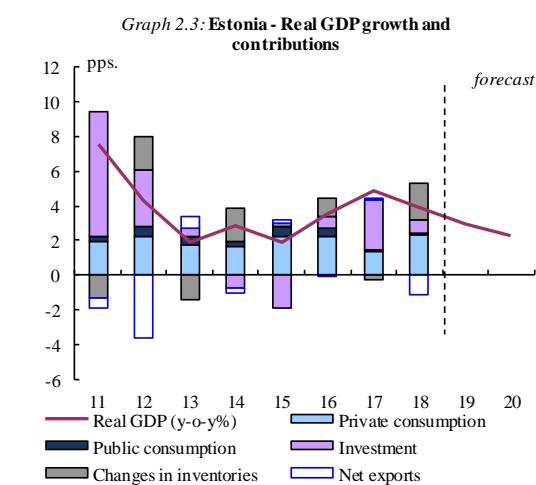
Core inflation (excluding energy and unprocessed food) is expected to stay unchanged in 2019 and

marginally increase in 2020, driven by solid wage growth and consumer demand. Inflationary pressures do not seem as acute, as in some of the consumer services sectors the pass-through is muffled by productivity increases. Energy prices are projected to decrease and are expected to exert a disinflationary effect. Overall HICP inflation is expected to ease from close to 2% in 2018 to 1.4% in 2019 and 1.3% in 2020.

### 2.3. ESTONIA

Estonia's real GDP grew at the brisk pace of 3.9% in 2018 and year-on-year growth in the first quarter of 2019 was even stronger at 4.5%. Economic performance has been strong across all sectors, with private investment expanding particularly swiftly. Both employment and wages have continued to increase, reflecting the strength of the labour market.

Yet despite these signs of strength, consumer and business sentiment has trended downwards recently, suggesting a slowdown in the coming quarters. Real GDP growth is forecast to ease to 2.9% in 2019 and to moderate further to 2.3% in 2020. Increased labour costs have added to the downside risks for exporting industries, which are also set to be affected by the expected slowdown in Estonia's main trading partners. Both business and household investment are forecast to moderate in step with the economy. Still, employment and wage growth are likely to remain strong, raising the purchasing power of households and supporting private consumption as the main growth driver.



HICP inflation has been relatively high since 2017 due to energy and food price increases, as well as substantial hikes in excise duties on fuels and alcohol. After reaching 3.4% in 2018, inflation is set to cool markedly in 2019 and 2020 to 2.4% and 2.1% respectively. This moderation reflects the assumed trend in energy prices and the lowering of alcohol excise duties on 1 July 2019. At the same time, the continuing rise in wages is expected to drive up service prices.

#### 2.4. IRELAND

Ireland's domestic economy maintained its momentum in the first half of 2019. In 2019-Q1, employment soared by 3.7% year-on-year and the unemployment rate fell to 5%, a level last seen in 2007. Average weekly earnings rose by 3.4% compared to the same period last year, supporting household disposable income. Resilient retail sales in the first five months of 2019 suggest robust private consumption. Industrial production rebounded in the first four months of 2019 after a decline at the end of 2018. On a year-on-year basis, construction output increased by 5.9% in 2019-Q1 and new dwelling completions accelerated to 23.2%.

Ireland's trade and investment figures remain volatile and heavily influenced by the activities of multinationals. The high share of pharmaceuticals and ICT services makes Irish exports less sensitive to changes in overall global demand. Nevertheless, the positive net export contribution to GDP growth is forecast to decrease over the forecast horizon in line with the expected weakening of external demand in key export markets.

Domestic activity is projected to continue growing at a solid pace with robust private consumption growth underpinned by strong growth in employment and wages. Investment in construction is forecast to expand at a brisk pace. As a result, real GDP is forecast to grow by 4.0% in 2019 and to moderate to 3.4% in 2020, on the back of less favourable prospects in key export markets, increasing capacity constraints and a slowdown in government expenditures.

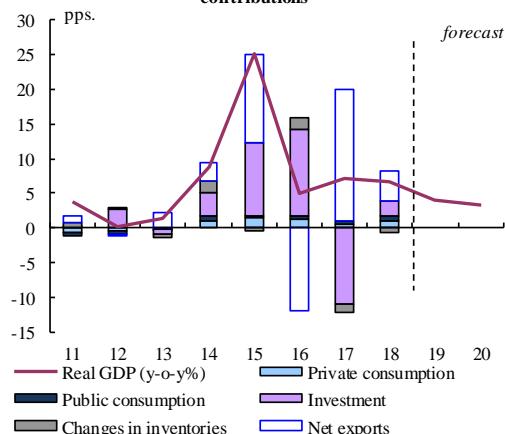
HICP inflation averaged 1.1% in the first five months of 2019, driven by rising service and energy prices. The average for the whole of 2019 is forecast at the same rate, with the bottoming out of energy price inflation in line with oil price

assumptions. Inflation is then forecast to rise to 1.3% in 2020, mainly driven by service prices as wage pressures build up in a tight labour market.

The economic outlook remains clouded by uncertainty, particularly relating to the terms of the UK's withdrawal from the EU and changes in the international taxation environment. More generally, the difficult-to-predict activities of multinationals could drive headline growth in either direction.

In the absence of major negative external shocks, the risk of overheating could increase in the near term. The tight labour market and diminishing spare capacity point to an economy possibly operating above its potential. The use of volatile and potentially short-lived foreign-company sourced corporation tax receipts to stimulate domestic demand would also fuel overheating.

*Graph 2.4. Ireland - Real GDP growth and contributions*



#### 2.5. GREECE

Greece's GDP growth (year-on-year) decreased further in the first quarter of 2019 but policy measures are expected to provide a short-term boost to the economy.

According to provisional data, real GDP growth was 0.2% (quarter-on-quarter) in the first quarter of 2019 (in seasonally and working-day adjusted terms), which corresponds to a growth rate of 1.3% (year-on-year), down from 1.5% in the previous quarter. This slowdown highlights the fragile nature of Greece's recovery.

Growth in the first quarter was mainly driven by a rebound in investment, particularly in non-

residential construction and equipment investment. Private consumption recovered its loss from the previous quarter thus adding modestly to domestic demand growth. The external sector, however, was a considerable drag on growth, and public consumption declined as well. Both factors suggest that some of the downside risks highlighted in the previous forecast have started to materialise.

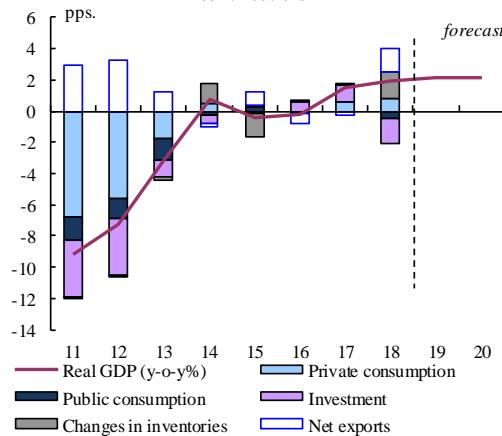
Private consumption is expected to pick up in the rest of the year and thus compensate for some of the unfavourable developments in the external sector. In addition to the positive effect of the minimum wage increase to household disposable income, which may be more pronounced in the second quarter, fiscal measures legislated in May 2019 should provide further support to private consumption. Overall, real GDP growth is forecast to reach 2.1% in 2019 and accelerate slightly to 2.2% in 2020 as private investment picks up. Downside risks are related to the stronger-than-expected pass-through of the weakening external environment and under-execution of the budget.

Price pressures remain muted, with consumer price inflation at 0.6% in May, which corresponds to a 0.8% rise over the first five months of the year. Recent decreases in the VAT rate indicate downside risks to the inflation forecast, but the effect of the tax changes could be offset by the consumption stimulus.

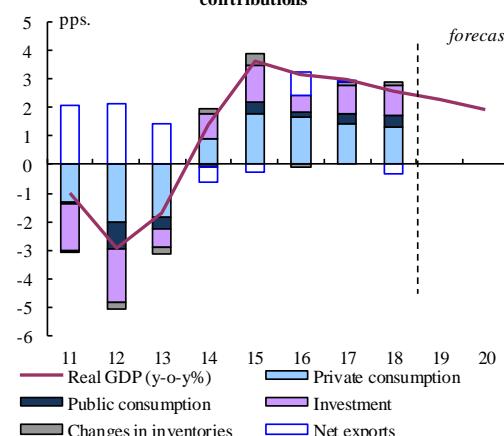
Exports, as imports contracted slightly. On the domestic side, dynamic equipment and housing investment offset weak consumption growth. Survey and activity indicators for the second quarter point to a deceleration, with growth expected at 0.6% (quarter-on-quarter). This is nevertheless higher than projected in spring, as consumption regains some momentum. As a result of the higher than expected growth in the first half of this year, real GDP is now forecast to expand by 2.3% in 2019, 0.2 pps. higher than projected in spring.

Growth is expected to ease slightly further in the third quarter of 2019 and to stabilise at a rate of about 0.5% (quarter-on-quarter) for the remaining quarters of the forecast horizon, broadly unchanged compared to spring. The annual GDP growth rate forecast for 2020 remains unchanged at 1.9%. In terms of composition, domestic demand, and in particular consumption, is expected to remain the main growth driver, with a broadly neutral contribution of net exports to growth. In a context of global trade tensions, Spain's exports and imports are still expected to recover, but by less than anticipated in spring. Employment growth should slow down over the forecast horizon, but continue to expand robustly, allowing for further reductions in the unemployment rate. Together with wage increases, this should support disposable income growth and a higher household saving rate.

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



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



## 2.6. SPAIN

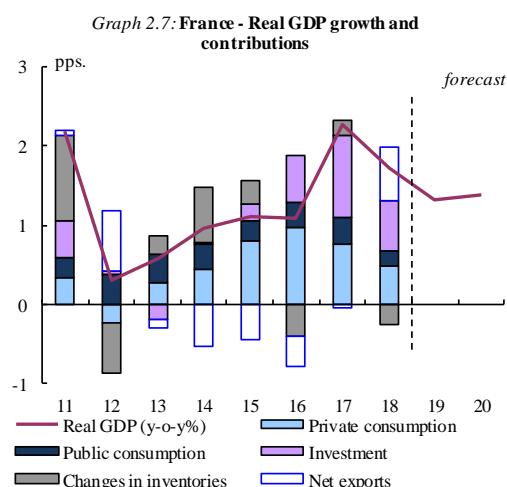
Real GDP growth was stronger than expected in the first quarter of 2019, when it accelerated to a rate of 0.7% (quarter-on-quarter). The growth surprise arose from the positive contribution of net

Headline inflation reached 1.7% in 2018 and is forecast to decline to 0.9% this year, mainly due to base effects from oil price developments. It is then set to increase to 1.2% in 2020, as core inflation gradually picks up.

## 2.7. FRANCE

France's GDP growth in 2018 was revised slightly upwards to 1.7%, according to annual national account data. Economic activity expanded by 0.3% (quarter-on-quarter) in the first quarter of 2019, as private consumption rebounded while net exports weighed on economic activity. GDP growth is forecast to remain broadly constant in the second quarter of 2019. On average, business sentiment indicators and PMIs were relatively well oriented in the second quarter of 2019, and consumer confidence kept improving. On the downside, weaker external demand is expected to weigh on economic activity.

Annual GDP growth, calendar-unadjusted, is set to decrease to 1.3% in 2019 and to reach 1.4% in 2020. Working-day adjusted growth is forecast at 1.3% in both 2019 and 2020. Domestic demand is expected to be the main growth driver with private consumption forecast to gain momentum over the forecast horizon. Favourable labour market conditions and fiscal measures have contributed to significant gains in purchasing power since the end of 2018. This has led to an increase in the household saving rate, which should decrease gradually and feed private consumption as consumer confidence improves.



Although investment is set to cool down, it should remain more dynamic than economic activity in general. Household investment is expected to recover gradually in 2020, while public investment is forecast to expand further in 2019 and to contract in 2020, in line with local investment. Business investment growth is set to decrease due to increasing external uncertainties and the deceleration of economic activity. Net exports are

expected to weigh slightly on GDP growth. Export growth is forecast to ease in line with the deceleration in global trade, while imports are expected to be more dynamic, reflecting the strengthening of domestic demand.

HICP inflation is forecast to decline to 1.3% in 2019 and reach 1.4% 2020, reflecting the fall in oil prices and lower tax increases. Despite the uptick in wages, core inflation is forecast to remain broadly constant in 2019 and 2020, as firms are expected to limit the transmission of rising labour costs to prices. Some measures are also set to weigh slightly on core inflation (calendar of tobacco taxes increases, decrease in social rents).

## 2.8. ITALY

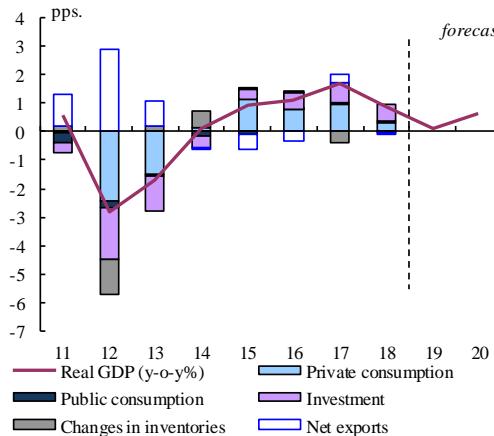
In the first quarter of 2019, real output rose by 0.1% in Italy on the back of a rebounding industrial sector and rising construction activity, the latter also boosted by mild weather conditions. In addition, large-scale stockpiling by UK-based companies helped stabilise exports. However, a marked downward adjustment of inventories limited the scope for real output growth. In March, manufacturing output slipped back into contraction and continued to shrink in April, while business and consumer surveys indicate subdued economic activity in the near term. With the likely reversal of temporary growth-supporting factors in the first quarter and the continuing weakness of external demand, real GDP is likely to have been stagnant in the three months up to June. Economic activity is not expected to rebound meaningfully before the end of the year.

Amid a challenging external environment real GDP growth in 2019 as a whole is forecast to be marginal (0.1%). In 2020, economic activity should rebound moderately to 0.7% in line with the gradual improvement of the global trade prospects and benefiting from a positive carryover effect and a calendar effect, given that 2020 has two working days more than 2019. However, risks to the growth outlook remain pronounced, especially in 2020, when fiscal policy faces particular challenges.

Over the forecast period, real GDP growth is set to rest largely on private consumption, supported by lower energy prices and the new citizenship income scheme for low-income earners. However, these positive factors are likely to be partially

dampened by a less dynamic labour market and declining consumer confidence associated with a rise in precautionary savings. Capital expenditure, especially equipment investment, is expected to remain muted, given subdued demand prospects and policy-related uncertainty. However, financial market tensions have recently ebbed, owing initially to expectations of easier monetary policy and further helped by the fiscal correction adopted by the Italian government via its 2019 mid-year budget. The related compression of sovereign yields, if sustained, might ease banks' funding costs and support corporate lending. In line with the sizeably weaker outlook for global trade this year, export growth is projected to lose momentum in 2019 but to gradually strengthen in 2020 on the back of firming external demand.

Graph 2.8: Italy - Real GDP growth and contributions



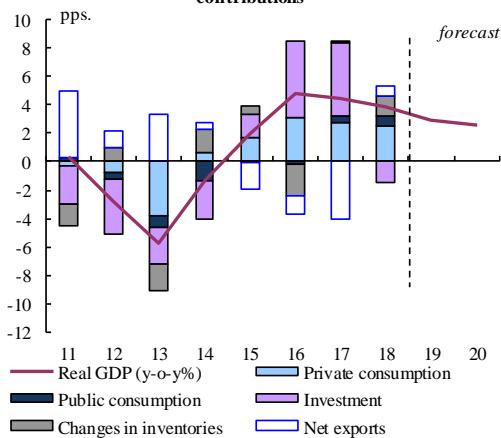
After job losses in the second half of 2018, employment increased marginally in the first five months of 2019 and the unemployment rate dropped below 10% in May. But weak economic activity is likely to weigh on the labour market as indicated by the rising number of workers supported by the wage guarantee fund (Cassa Integrazione Guadagni, CIG), which compensates for the income lost due to reduced work hours, and firms' markedly lower employment expectations.

HICP inflation fell in May after an Easter-related uptick in April. Consumer prices are set to increase by 0.8% in 2019 and by 1.0% in 2020 on the back of lower oil prices and a limited pass-through of wages to final sales prices in the context of subdued domestic demand.

## 2.9. CYPRUS

Cyprus' real GDP expanded by a solid 3.9% in 2018, driven by strong domestic consumption and still favourable external demand for Cypriot exports. Economic growth slowed in the first quarter of 2019 to 3.4% (year-on-year), mainly reflecting weaker exports. Consumer sentiment has deteriorated over the first half of 2019 and business confidence has steadied, suggesting that growth could be less buoyant in the months to come.

Graph 2.9: Cyprus - Real GDP growth and contributions



Private consumption is nevertheless expected to remain resilient, given positive labour market developments. The unemployment rate fell to 6.5% in May, its lowest level in eight years. Public spending is also set to provide support. Investment recorded healthy growth in the first quarter of the year and bank lending to domestic non-financial companies is firming. However, one of the pillars of the Cypriot economy – tourism – is showing signs of weakness. Tourist arrivals decreased by 1.1% over the first five months of 2019 compared to the same period in 2018. This interruption in a long upward trend partially reflects the bankruptcy of certain airlines servicing Cyprus, as well as slowing tourism demand. But revenue from tourism in the first quarter also is estimated to have fallen, by 3.1% compared to the corresponding period in 2018, likely due to more intense competition.

Overall, real GDP is projected to grow by 2.9% in 2019 and 2.6% in 2020. Slowing tourism and escalating trade tensions globally are likely to weigh on export revenues and investment decisions, leading to a more moderate growth than expected in spring.

HICP inflation remains low. After a more pronounced rise in January when it breached 2% year-on-year, HICP fluctuated around 1% in the period February-April and then eased in May. The major factor behind low inflation were prices of non-energy goods, which continued falling compared to a year ago. The contribution of most other HICP components, by contrast, was positive. Lower oil prices, however, are set to drive inflation down in the second half of 2019 to an annual rate of 0.5% and inflation is expected to average 0.9% in 2020.

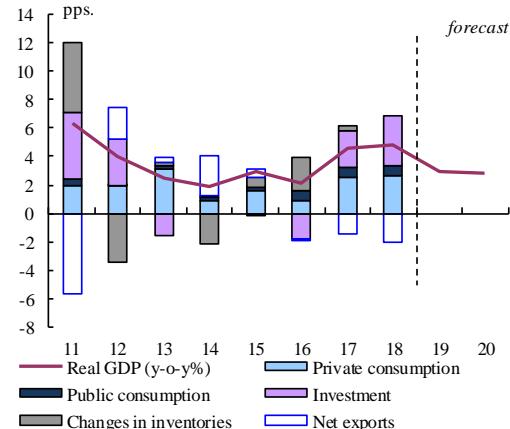
## 2.10. LATVIA

Following strong, investment driven growth of 4.8% in 2018, GDP growth in Latvia cooled down considerably in the first quarter of 2019, to stand at 3.0% year-on-year. While all domestic demand components slowed compared to the previous year, export growth picked up slightly relative to its disappointing growth in 2018. Looking ahead, confidence indicators have trended slightly downwards in recent months, but they remain somewhat above long-term averages, pointing to robust GDP growth in the second quarter of 2019.

Full-year GDP growth in 2019 is forecast to slow to 3.0%, driven mainly by private consumption and, to a lesser extent, by exports and investment. The slowing of private consumption is due to an expected moderation in employment growth but wage growth is expected to remain rapid and supportive. Investment growth is set to decelerate markedly as the peak of EU funding approaches providing relatively little support to investment growth in 2019 and none in 2020. Export growth is set to recover slightly after a disappointing 2018, but slowing EU growth and trade implies that a strong rebound is unlikely.

In 2020, real GPD growth in Latvia is expected to slow further to 2.8%, as investment is projected to level out and private consumption to slow further as a result of lower employment growth and falling consumer confidence. Unemployment is forecast to fall further over the coming years, mainly because the labour supply is expected to continue falling. As a result, labour market conditions should remain tight and maintain pressure on wage growth.

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



HICP inflation is forecast to increase from 2.6% in 2018 to 3.1% in 2019 due to recovering food prices and an acceleration of service prices. Inflation is forecast to decrease to 2.5% in 2020 as the rise in food prices moderates and the pressure from wage growth on service prices eases.

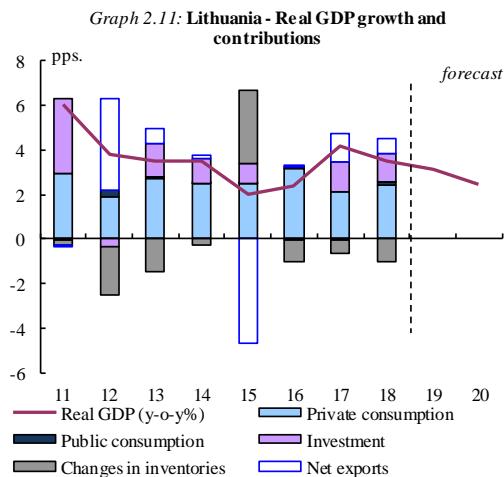
## 2.11. LITHUANIA

Following solid growth of 3.5% in 2018, Lithuania's economy maintained its strong momentum in the first quarter of 2019, with real GDP growing 1.0% quarter-on-quarter and outperforming expectations. As in 2018, economic growth was broad based. A strong labour market situation and the reduction in labour taxes supported private consumption, while a pick-up in the usage of EU funds boosted investment and exports proved resilient in the face of negative global trade prospects.

The most recent data points to a continued strong performance of the manufacturing and construction sectors. Confidence indicators remained well above long-term averages, especially consumer confidence. Therefore, domestic demand is projected to further drive economic growth. On the other hand, a weak outlook for Lithuania's main trading partners is expected to lead to a more notable deceleration in export growth. Overall, real GDP growth in Lithuania is forecast at 3.1% in 2019 and 2.4% in 2020.

After slowing to 2.5% in 2018, headline inflation is expected to moderate further to 2.2% in 2019 and 2.1% 2020. As oil prices are assumed to fall, energy prices are expected to put less upward

pressure on inflation than in recent years, despite the recent increases in gas and electricity prices for households. Dynamic wage growth is expected to continue to have a strong impact on service prices, accounting for about a half of headline inflation.

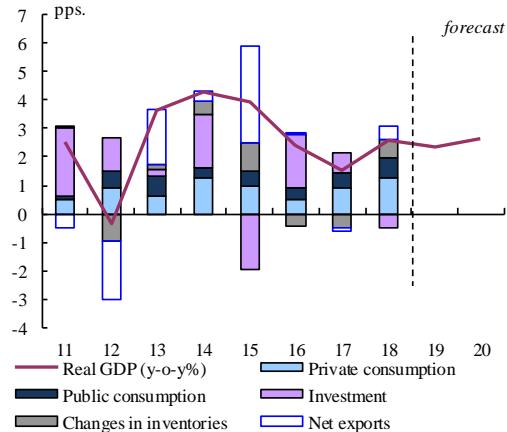


## 2.12. LUXEMBOURG

Economic growth in Luxembourg turned out at 2.6% in 2018, in line with the average annual rate between 2015 and 2018. Growth continued to be driven mainly by strong private consumption with some additional support from foreign demand. Although Luxembourg's economic performance tends to be highly correlated with international financial markets, which had been recovering until April, the high level of uncertainty means that the country's financial sector is expected to make a relatively moderate contribution to growth. However, Luxembourg's national accounts data are subject to frequent and substantial revisions and, therefore, they need to be taken with caution.

Private consumption growth, the main driver of domestic demand, should continue to benefit from strong labour market conditions. In addition, budgetary measures and indexed increases in wages and pensions last year and this year should also support household purchasing power. However, employment support is expected to weaken in line with slowing job creation, especially among the resident population. Overall, despite supportive domestic demand, GDP growth is forecast to ease to 2.4% in 2019 before perking up again slightly to 2.6% in 2020.

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

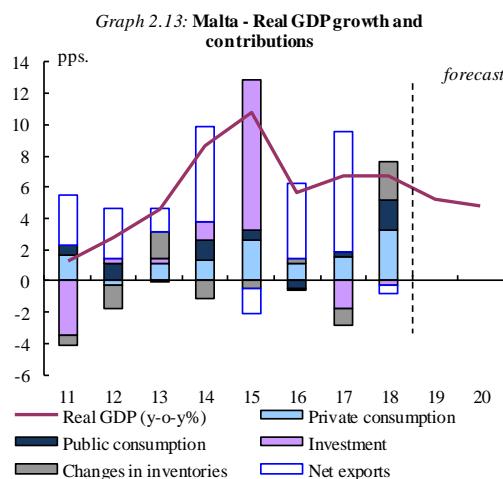


HICP inflation fell marginally to 2.0% in 2018 from 2.1% in 2017. Downside factors, such as subsidies for child and healthcare services introduced in November 2017, more than offset the effect of higher oil prices, which continued feeding into higher inflation in 2018. Falling oil prices are expected to ease headline inflation in 2019 and 2020. Meanwhile, domestic price pressures, including from past wage increases, are set to reassert their influence, although these will be offset by new measures to be implemented in 2020, including free public transport on the national network. All in all, headline inflation should fall to 1.7% in 2019 and 1.6% in 2020.

## 2.13. MALTA

Malta's economy grew by 6.7% in 2018, making it the fifth year in a row in which real GDP has grown by over 5%. The structural shift towards a fast growing, internationally-oriented services sector is the main factor behind Malta's recent economic success.

Domestic demand was the main growth driver in 2018, replacing net exports. In particular, strong employment growth boosted household disposable income, resulting in record-high private consumption. In the first quarter of 2019, domestic demand was underpinned by public consumption and investment, while private consumption growth eased slightly. At the same time, net exports declined as a result of strong import growth. Consumer confidence remained above its historical average, but overall sentiment began to deteriorate in March, particularly in the services sector.



While growth momentum is expected to remain solid, GDP growth is forecast to moderate in 2019 and 2020 to 5.3% and 4.8%, respectively. This is the result of private consumption growth gradually moderating, mirroring the pace of job creation. Public expenditure is expected to increase faster than private consumption, as the government makes use of the fiscal space it has accumulated over recent years. Investment is expected to remain robust over the forecast horizon, supported by planned infrastructure and health projects. Looking at the external sector, import growth is set to pick up in parallel with investment growth, narrowing the large current account surplus.

After reaching 1.7% in 2018, inflation was subdued in the first months of 2019 before accelerating in April, driven by rising food prices. Prices are expected to further increase during the peak tourism season and then slightly decelerate, pushing headline inflation to 1.8% in 2019 and 1.9% in 2020.

## 2.14. THE NETHERLANDS

After recording an increase of 2.6% in 2018, real GDP growth remained solid in the first quarter of 2019 at 0.5% (quarter-on-quarter). However, the economic expansion is set to slow in the face of a weaker external environment. Annual real GDP growth is forecast to moderate to 1.6% in 2019 and 1.5% in 2020, with domestic demand being the main growth driver.

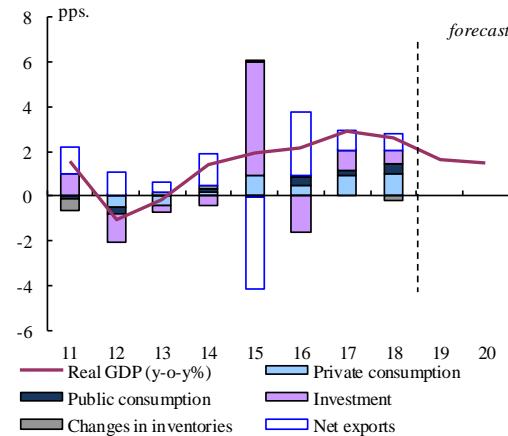
The labour market continues to be tight and employment growth remained strong in early 2019. Together with a gradual increase in wages, this should support an increase in private

consumption over the forecast horizon, albeit at a slower pace than in previous years following the marked decline in consumer confidence.

Investment is still projected to record a solid increase in 2019 due to strong growth in the past two quarters, amid high capacity utilisation and positive business sentiment. However, the lower growth momentum overall, coupled with global uncertainty, is expected to lead to lower growth in corporate investment in 2020. Growth in residential investment is also projected to moderate, in line with a stagnation in residential building permits and housing transactions. The main reason for the decline in growth, particularly in 2019, however, is lower export growth. Exports are expected to weaken in line with the weakness in global trade and lower growth in the Netherlands' main trading partners. Growth should receive some support from higher government spending, which is set to increase in the areas of defence, infrastructure and education.

An increase in the reduced VAT rate and higher energy taxes are expected to push inflation from 1.6% in 2018 to 2.5% this year. As the effect of higher indirect taxes dissipates and oil prices fall, inflation in 2020 is forecast to decline to 1.4%.

**Graph 2.14: The Netherlands - Real GDP growth and contributions**



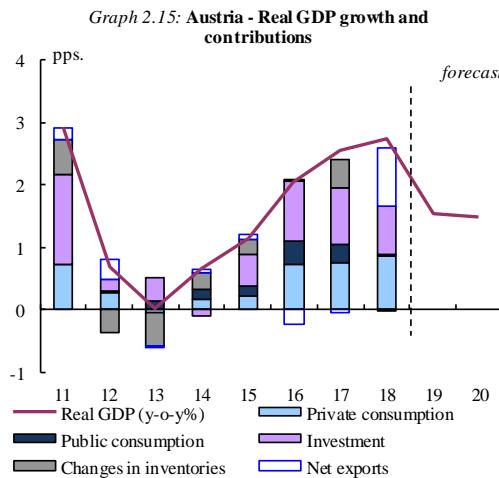
## 2.15. AUSTRIA

Austria's economy maintained a solid and broad-based momentum in the first quarter of 2019. Private consumption and investment, particularly in construction, grew strongly. After brisk growth in 2017 and 2018, export growth dampened only slightly in the first quarter of 2019. However, given the decline in import growth, net exports contributed positively to overall economic growth.

Real GDP is forecast to grow at a more moderate pace in 2019 and 2020 - by 1.5% in each year - mainly due to a moderation in the global economic outlook. Over the forecast horizon, growth is set to be mainly driven by domestic demand. The weakened growth prospects are also reflected in sentiment indicators, which have been gradually deteriorating since the start of 2018. The largest decline is visible in industrial confidence, while services and construction sentiment indicators have eased but remain at elevated levels. Private consumption is expected to remain the main contributor to growth, fuelled by increasing wages, employment growth and the tax relief provided by the new 'Family Bonus plus' measure. Equipment investment growth is set to weaken amid the high level of uncertainty. However, investment in residential construction is expected to remain solid and to decrease only gradually, as there is still excess housing demand.

The outlook for foreign demand has subsided. Lower growth in important trading partners is expected to put a drag on net export growth in the remaining quarters of 2019. Import growth is expected to decline to a lesser extent, as domestic demand remains solid.

In 2018, the rise in oil prices kept headline inflation above 2%, while core inflation decreased to 1.9%. In 2019 and 2020, the assumed moderation in energy prices is expected to lower headline inflation to 1.7% in both years.



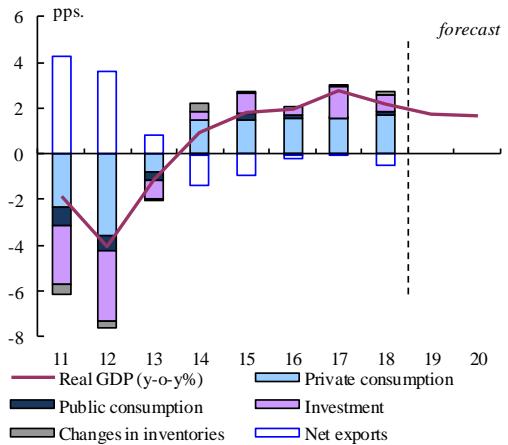
## 2.16. PORTUGAL

Portugal's GDP grew by 1.8% (year-on-year) in the first quarter of 2019, as strong domestic

demand more than offset weak net exports. Private consumption growth slowed down slightly but investment rebounded strongly, supported by all main components. At the same time, this pushed up imports and contributed to the more negative contribution of net exports. The Commission's Economic Sentiment Indicator (ESI) rebounded somewhat towards the end of the second quarter of 2019 but remained below the level from a year earlier. Available hard data meanwhile suggest that the services sector, notably tourism, continues to support growth while industrial performance is suffering from lower external demand.

GDP growth is projected to ease marginally over the forecast horizon reflecting mainly a less supportive external environment. Growth in private consumption is also set to weaken, while investment is forecast to accelerate, maintained by the absorption cycle of EU funds. Overall, GDP growth is estimated at 1.7% in both 2019 and 2020. Risks to the outlook remain on the downside, reflecting the recent increase in the volatility of the country's industrial output and foreign trade balance.

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



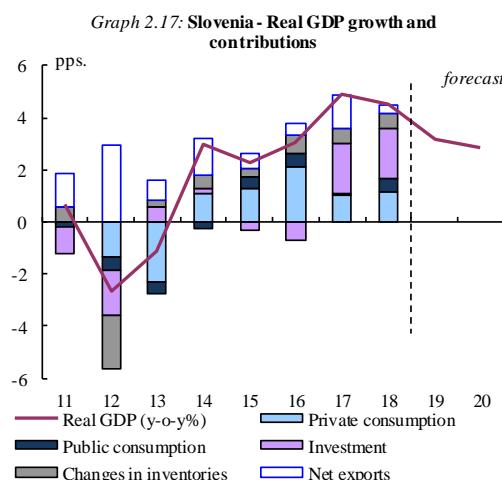
Inflation remains significantly below the EU average, slowing further to 0.7% in June. Apart from the continuous decrease in prices of industrial goods, inflation is dampened by lower oil prices and regulatory constraints in the prices of energy and public transportation. Wage growth is higher than inflation but its impact on aggregate demand is partly offset by the recent slowdown in employment growth. Overall, annual inflation is projected at 0.9% in 2019 and 1.5% in 2020. The expected rebound in 2020 is set to be mainly demand-driven with core inflation hovering slightly above the headline rate. Meanwhile, house

prices continued growing at a fast rate, above 9% (year-on-year) in the first quarter of 2019, slowing only marginally in comparison with the last two years. The gradual increase in housing supply is expected to contribute to some moderation in house prices but the pace of adjustment is likely to remain slow.

## 2.17. SLOVENIA

Slovenia's economic growth reached 4.5% in 2018. Growth was driven mainly by domestic demand, in particular by strong investment dynamics. Net exports also contributed positively as the current account surplus continued to grow. In the first quarter of 2019, the economy expanded by 0.8%. Growth continued to be driven primarily by investment but consumption and export growth also remained robust. Economic sentiment has worsened since the beginning of 2019 but still remains above its long-term average. Employment growth remained steady and the unemployment rate further declined to 4.8% in the first quarter.

In 2019 and 2020, growth is expected to slow down to 3.2% and 2.8%, respectively. With strong employment and continued wage growth, consumption is expected to strengthen. Although investment growth is set to moderate compared to the very high level of 2018, favourable financing conditions, high levels of capacity utilisation and a more intensive use of EU funding suggest that it may remain an important growth driver. At the same time, at the beginning of 2019, import growth exceeded export growth, suggesting that the positive contribution to growth of net exports may not last.



HICP inflation was 1.3% in the first quarter of 2019. Due to the assumed fall in fuel prices, energy prices are expected to have a somewhat lower impact on inflation than previously forecast. On the other hand, wage increases, particularly in the services sector, are expected to create some upward pressure on prices. Overall, consumer price inflation is forecast to average 1.7% in 2019 and 2.0% in 2020.

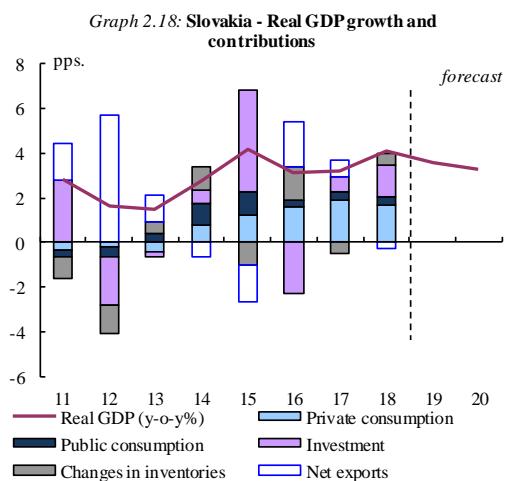
## 2.18. SLOVAKIA

Economic growth in Slovakia remains strong but is projected to moderate from 4.1% in 2018 to 3.6% in 2019 and 3.3% in 2020. Conditions remain favourable for domestic demand to continue fuelling GDP growth, albeit at a somewhat slower pace than in 2018. While remaining the key driver of overall growth, private consumption growth is expected to slow slightly in 2019 and 2020 compared to the preceding year, as an expected slowdown in employment growth may dampen otherwise robust growth in household disposable income.

In the first quarter of 2019, the economy grew by 0.9% quarter-on-quarter, supported mainly by net exports. Despite rising concerns about global trade prospects, net exports are expected to stimulate economic growth markedly in 2019, not least due to rising production volumes in the export-oriented automotive sector. These are likely to help offset the moderation in global demand. Moreover, Slovakia's export product mix – especially in higher-value automobiles – has proven relatively resilient to this moderation.

Investment activity is likely to normalise to more moderate growth rates from 2019 onwards as capacity-building in the automotive sector comes to an end. However, EU funds are projected to shore up overall investment activity.

Falling unemployment, general government wage hikes and a sharp rise in the number of job vacancies in 2018 have put upward pressure on the growth in labour earnings, which is expected to peak in 2019. This is forecast to significantly bolster household disposable income, allowing private consumption to maintain much of its recent momentum in 2019 and 2020. Net job creation is anticipated to continue in 2019 and in 2020, though at a slower pace than recently.



Consumer price inflation reached 2.5% in 2018, with all components contributing positively. In line with the tight labour market and rising wages, service price inflation picked up in 2018 and is set to play a major role in maintaining the consumer price inflation rate at 2.4% in 2019 and 2.3% in 2020.

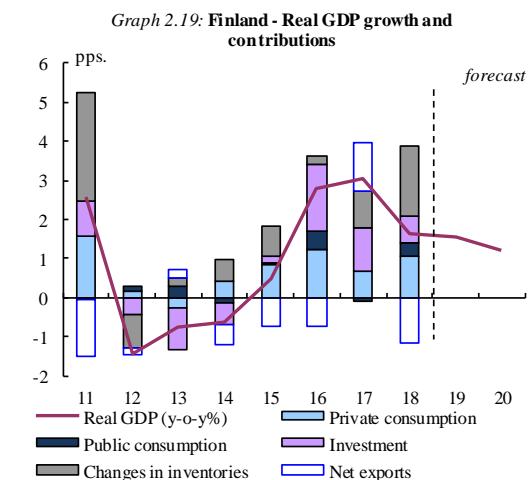
## 2.19. FINLAND

Real GDP in Finland grew by 1.7% in 2018 according to the most recent data revision, a sizeable slowdown from 3.0% in 2017. In the first quarter of 2019, preliminary data show that real GDP growth reached 0.6% quarter-on-quarter (0.9% year-on-year), led by exports and government expenditure. Indicative for 2019-Q2, most high-frequency indicators suggest that the economy's growth momentum has stalled. Real GDP growth this year is expected to ease to 1.5% while in 2020, growth is forecast to decrease to 1.2%, closer to the economy's potential level.

The economic outlook is weakening somewhat faster than expected in spring. While consumer confidence has decreased, higher disposable income and higher employment should support private consumption, which remains an important growth contributor. Investment is projected to grow further but at a slower place compared with 2018, due to a deceleration in construction activity. Exports are expected to pick up gradually, in line with the assumptions on global trade.

In line with the performance of the economy, HICP inflation remained subdued in the first five months of 2019 (1.3% annually). Only a gradual

increase is expected for 2020 on the back of rising labour costs.



Risks to the outlook are broadly balanced and predominantly external, in line with risks affecting the euro area. Domestically, the investment outlook is dependent on the possible execution of a few large projects, which represents both upside and downside risks.

## NON-EURO AREA

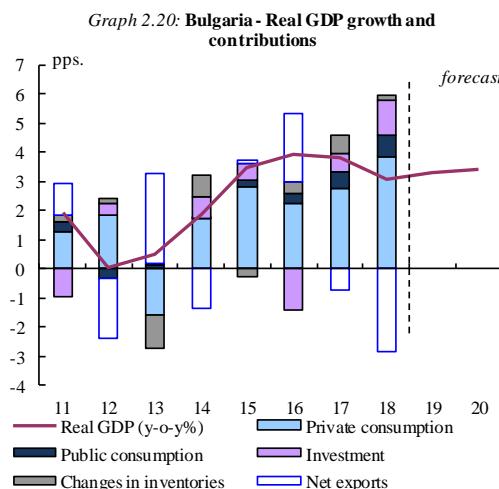
### 2.20. BULGARIA

Real GDP growth strengthened from 3.1% in 2018 to 3.5% (year-on-year) in the first quarter of 2019. The recovery in exports that had begun in the second half of 2018 continued in the first months of 2019 and contributed strongly to the economic expansion. Private consumption continued to exhibit robust growth, underpinned by favourable labour market outcomes and strong lending activity. Investment increased only slightly – while investment in equipment grew strongly, it was largely offset by declines in other investment components. Positive expectations about future economic activity and high capacity utilisation in industry prompted increases in private investment.

Real GDP growth is forecast to recover to 3.3% in 2019 and 3.4% in 2020, in line with the spring forecast. Due to the weakening external environment, Bulgaria's economy is expected to expand at a slower pace in the second half of this year and then maintain a similar growth rate throughout 2020. Positive trends in disposable income should help to sustain private consumption dynamics, while sound profits, accommodative

financing conditions and optimistic expectations about the domestic economy are set to stimulate investment activity. The balance of risks is tilted to the upside for the current year. Improved consumer confidence in combination with higher disposable income could spur more private spending. In addition, the rapid growth of exports to several relatively small destinations outside the EU in the first four months of 2019 suggests potentially high capacity for export reorientation. If the entry into new export markets is sustained, that could lead to better export performance.

Headline inflation decelerated at the end of 2018 as the effects of high energy prices and one-off statistical effects in services dissipated. In the first five months of 2019, however, inflation gathered pace again due to higher fuel prices and the continued rise of food prices. In the second half of the year, the envisaged price hikes in regulated energy prices will push up inflation, while the effects from energy and services price increases in 2018 will gradually disappear. Inflation is set to ease to 2.4% in 2019 and 1.7% in 2020.

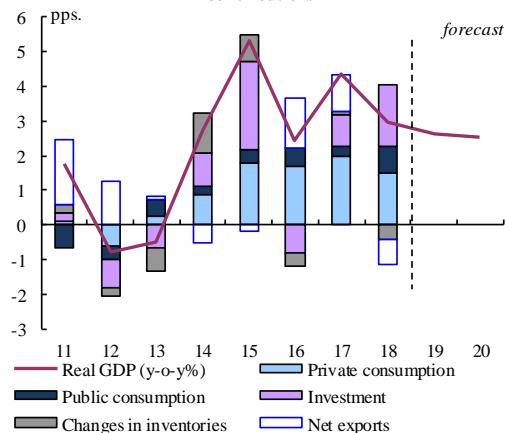


## 2.21. CZECHIA

The Czech economy grew strongly again in 2018. Real GDP expanded by 3.0%, mainly as a result of rapid growth in investment and solid growth in household consumption. The surge in gross fixed capital formation was mostly due to significant investments in automation, particularly in manufacturing, and the inflow of EU funds. The contribution of net exports to growth turned negative in 2018 as strong domestic demand pushed the growth of imports well above that of exports.

Real GDP growth is expected to ease slightly in 2019 and 2020 to 2.6% and 2.5% respectively, broadly in line with estimated potential growth rates. In the first quarter of 2019, the economy grew by 0.6% quarter-on-quarter and 2.8% year-on-year, supported mainly by domestic demand. Private consumption is likely to remain the main growth driver and should continue to benefit from swift growth in wages and pension incomes, and robust consumer confidence. After the surge in 2018, investment growth is expected to normalise in 2019 and 2020. However, on the back of the acute labour shortages, investment in automation will most likely remain a priority for firms. The trade balance is set to deteriorate over the forecast horizon and detract from GDP growth in 2019, before turning neutral in 2020. The growth rates of both exports and imports are expected to moderate somewhat, following the deterioration in global trade prospects.

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



Labour shortages and reliance on the external sector remain the main downside risks. The record high number of job vacancies across all sectors has led to a significant increase in real unit labour costs in the last couple of years. As the growth of labour productivity has been rather muted, the competitiveness of Czech exports risks being affected in the longer term.

HICP inflation has been picking up in 2019 so far, influenced by steeper prices for energy, services and food. The inflation rate is expected to reach 2.4% in 2019, slightly above the Czech National Bank's target of 2%, before moderating to around 2.1% in 2020, when inflationary pressures from energy are expected to subside.

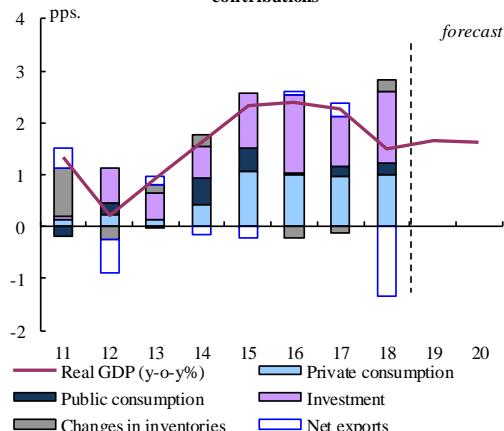
## 2.22. DENMARK

Real GDP grew by 0.1% quarter-on-quarter and by 1.9% year-on-year in the first quarter of 2019, mainly driven by investment and private consumption. Employment growth remained robust at a year-on-year rate of 1.5%, down slightly from the 1.8% achieved in 2018; while industrial production and goods exports both grew by 5% year-on-year over the same period.

The Danish economy is well positioned to maintain solid annual growth rates over the forecast horizon in line with its potential. The country's industrial production is specialised in goods that appear less sensitive to changes in the global economic cycle, such as pharmaceuticals and wind turbines. This has helped Denmark so far to avoid a marked slowdown despite deteriorating global demand. Private consumption growth is projected to remain robust this year and next, supported by the continuing strength of the labour market and steadily rising disposable incomes. With employment expectations still high, particularly in the manufacturing sector, employment growth is expected to remain steady. On the other hand, stagnating housing prices and a further decline in new building permits suggest that the slowdown in housing investment will continue. Exports remain vulnerable to the economic slowdown in major trading partners and frictions in world trade. Real GDP growth is forecast to reach 1.7% in 2019. With solid domestic demand, import growth is set to outpace export growth in 2020. As a result, GDP growth is forecast to ease slightly to 1.6%, unchanged compared to spring.

So far, domestic price pressures have remained subdued, despite the economic upswing and dynamic rise in wages. HICP inflation in the first five months of this year has averaged only 1%, due largely to weak import price inflation. HICP inflation is forecast to remain around 1% this year, but to increase somewhat to 1.4% in 2020, when the pass-through from wage increases to prices is expected to strengthen.

Graph 2.22: Denmark - Real GDP growth and contributions



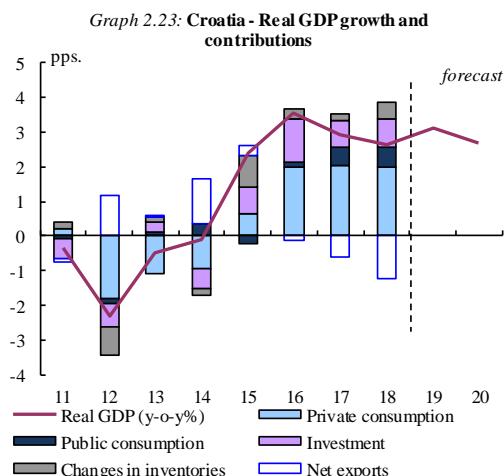
## 2.23. CROATIA

Croatia's economy grew by 2.6% in 2018, slightly less than expected due to a particularly weak fourth quarter. However, real GDP growth rebounded beyond expectations in the first quarter of 2019 by 1.2% quarter-on-quarter. Domestic demand remained the main driver of growth due to strengthening investment and robust household consumption. Exports rebounded following an unexpected contraction in the previous two quarters. High frequency indicators, labour market and survey data all suggest strong domestic demand-driven growth should continue throughout 2019.

As wages and employment continue to grow amidst low inflation, household consumption is set to remain the main driver of growth throughout the forecast period. Investment growth is expected to strengthen further in 2019 before moderating in 2020, supported by an improved uptake of EU funds and low interest rates. Goods exports are expected to rebound in 2019, while service exports are expected to continue easing as supply side constraints become more evident and international competition in the tourism sector intensifies. Strong final demand growth should be reflected in a pick-up in imports of both goods and services in 2019. Overall, the contribution of net exports to growth is expected to decrease further in 2019 before improving in 2020, though remaining negative. Real GDP growth is forecast to pick up to 3.1% in 2019 as a whole before moderating to 2.7% in 2020.

Employment growth should moderate over the forecast horizon and the unemployment rate is

expected to continue declining towards an historic low in 2020.



In the first five months of 2018, inflationary pressures remained subdued due to negative inflation in unprocessed food prices as a result of changes in the applicable VAT rate adopted in September 2018. As labour shortages become more apparent in some sectors, wage growth is projected to accelerate. However, the reduction in the standard VAT rate in January 2020 and stagnating energy prices should dampen inflation. Overall, inflation is forecast to remain subdued at 0.9% in 2019 and 1% in 2020.

## 2.24. HUNGARY

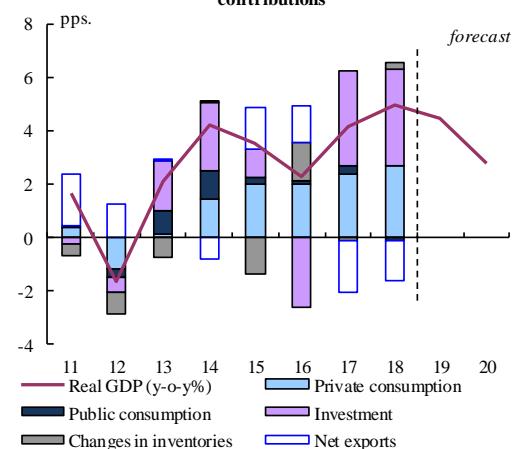
Hungary's economy grew by 4.9% in 2018, thanks to the robust expansion of consumption and investment. GDP growth strengthened further in the first quarter of 2019 to 5.3% year-on-year. Growth received a boost from exports as the automotive industry switched into higher gear following several weaker quarters. Construction activity benefitted from the mild winter and the sector's output grew by over 46% year-on-year in the first quarter. According to monthly business indicators and surveys, year-on-year GDP growth remained robust in the second quarter of 2019. However, new orders have not kept pace with construction activity recently and the order book of construction companies was already shrinking by 6% year-on-year in April. This foreshadows a marked slowdown in investment activity and GDP growth over the coming quarters.

GDP growth is projected to reach 4.4% in 2019 and then slow to 2.8% in 2020. The investment

rate has already reached a high level and thus investment growth is projected to decelerate in 2020. With the economy near full employment, job creation is set to slow and this should moderate private consumption growth. Export growth is also forecast to slow due to the persistent weakness in key export markets. At the same time, strong domestic demand will continue to boost imports, deteriorating the trade balance.

HICP inflation rose to 4.0% in May 2019 on the back of rising fuel and food prices. As these cost-side pressures fade, inflation is set to decrease in the second half of 2019. However, core inflation (excluding energy and unprocessed food) should remain near 4% because strong demand allows rapid wage growth to feed into consumer prices. The gross average wage increased by 10.4% in the first four months of 2019 due to the tight labour market and minimum wage hikes. The continuing rise of excise duties on tobacco will add around 0.2 pps. to inflation in 2020. Overall, HICP inflation is projected at 3.2% in both 2019 and in 2020.

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



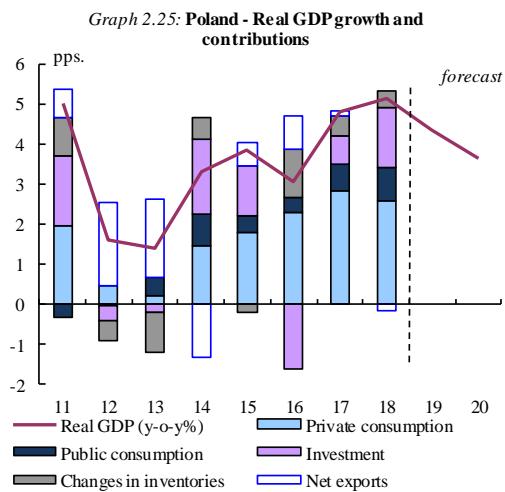
## 2.25. POLAND

Poland's economy grew by 5.1% in 2018 and GDP growth in the first quarter of this year remained strong at 1.5% quarter-on-quarter, mainly driven by investment and private as well as public consumption. Business sentiment indicators weakened in the second quarter, but generally remained above their long-term averages, and consumer confidence stayed close to multiannual highs.

Private consumption is expected to strengthen in the second half of 2019 and in early 2020, as new

fiscal transfers and tax cuts increase household disposable income. Together with strong wage growth and favourable labour market trends, this is expected to support consumer confidence. Investment growth continues to be supported by EU funds, and is set to remain strong in 2019, before slowing in 2020. The dynamics of both exports and imports are set to gradually moderate during 2019 and 2020. Overall, real GDP growth is expected to reach 4.4% in 2019 and 3.6% in 2020. Risks are slightly tilted to the upside for 2019 and mainly relate to net export and private investment growth. Risks to the 2020 growth outlook are slightly tilted to the downside.

Inflation rose in the second quarter of 2019, with faster wage increases visible in many sectors, in particular in services and food products. Inflation is forecast to rise from 1.2% in 2018 to 2.1% in 2019 before increasing further to 2.7% in 2020. Fast wage growth is projected to have a particularly strong impact on service prices throughout the forecast horizon. Energy price inflation is expected to remain low in 2019 and to increase in early 2020, following the removal of administrative controls on electricity prices.



## 2.26. ROMANIA

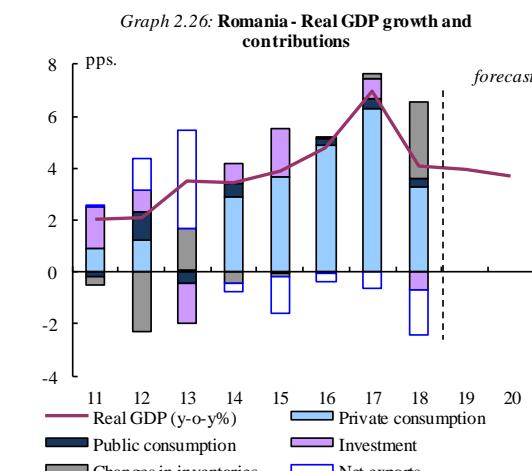
Following an annual growth of 4.1% in 2018, real GDP growth accelerated in the first quarter of 2019 to 5.1% year-on-year (1.3% quarter-on-quarter). Private consumption remained the main driver, increasing 7.0% year-on-year thanks to still double-digit wage growth. Investment picked up, thanks mainly to a recovery in construction, spurred by recent fiscal stimulus. Export growth,

by contrast, weakened to 3.2% year-on-year, while import growth climbed to 9.3%.

The strong growth of real GDP in the first quarter led to an upward revision of growth for the whole year. Annual real GDP growth is forecast to mildly ease to 4% in 2019 and 3.7% in 2020. However, the composition of growth is expected to become somewhat more balanced as total investment strengthens with a pick-up in private investment.

Tight labour market conditions are expected to continue over the forecast horizon, with unemployment remaining close to its current, very low level. Wage growth is forecast to moderate to single digits in 2020, led by the expected slowdown in public wage growth.

In 2018, HICP inflation stood at 4.1%, the highest in the EU. Annual consumer price growth remained strong in the first quarter of 2019, at 3.8%, and is expected to exceed 4% in the second quarter, before decelerating again. Rising unprocessed and processed food prices explain the strong upward price dynamics boosted by a depreciation of the currency at the beginning of the year and strong consumption and wage growth. As a result, annual headline inflation is expected to average 4.2% in 2019, before decelerating to 3.7% in 2020. The deceleration in 2020 is expected to follow moderating wage pressures and softer domestic demand.

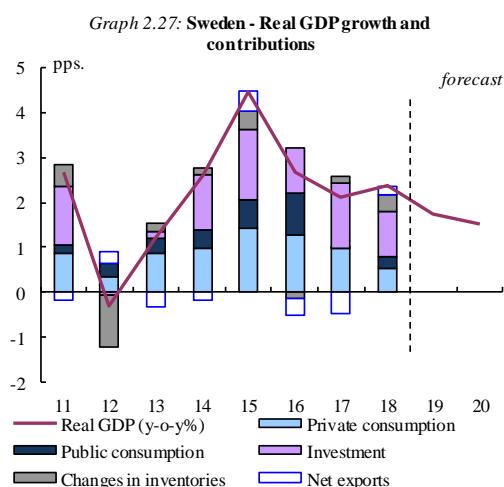


## 2.27. SWEDEN

Sweden's economy performed strongly in the first quarter of 2019 with real GDP rising by 0.6% quarter-on-quarter. This was entirely attributable to

strong net exports, mainly of services. By contrast, domestic demand shrank on the back of slumping investment, especially housing investment, and a slight decline in private consumption.

Short-term and leading indicators suggest that domestic demand is set to decelerate markedly on the back of weak investment and a tepid increase in consumption, dampened by moderate wage increases and a cooling labour market. Net exports should benefit from the strong competitiveness of Swedish exporters and the past depreciation of the krona, and are set to become a prominent driver of economic growth in 2019. In all, real GDP growth is forecast to slow down from 2.4% in 2018 to 1.7% in 2019. In 2020, an expected slight strengthening of domestic demand and a lower growth contribution from net exports are set to add up to real GDP growth of 1.5%.



Risks to the outlook are skewed to the downside. As growth has become more oriented towards exports, Sweden remains vulnerable to an economic slowdown among major trading partners as well as to trade disruptions. At the same time, further broad-based declines in the confidence of households and enterprises, coupled with a faster-than-expected deterioration in the labour market could lead to a stronger deceleration in the domestic economy.

HICP inflation is expected to fall to 1.7% in 2019 after 2.0% in 2018, reflecting lower contributions from energy and unprocessed food prices. Core inflation, as measured by the overall index excluding energy and unprocessed food, is set to remain relatively subdued. In the absence of domestic price pressures and with global energy prices set to fall over the forecast period, HICP

inflation is projected to remain broadly unchanged at 1.6% in 2020, around the expected rate of core inflation. The rate of wage increases in the upcoming collective wage agreement negotiations will be a key determinant for the inflation outlook in the medium term.

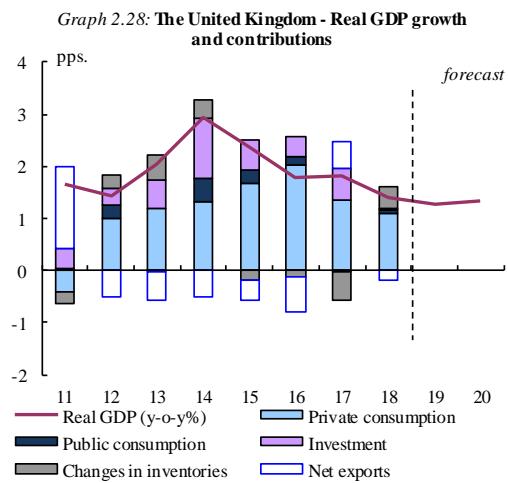
## 2.28. THE UNITED KINGDOM

Stockpiling and other actions taken by UK businesses to mitigate the uncertainties surrounding the date and nature of the UK's exit from the EU, temporarily boosted growth in the first quarter of this year. Real GDP rose 0.5% (quarter-on-quarter) in 2019-Q1, above the average 0.3% growth rate observed in 2018. However, evidence from a range of business surveys and April's weak GDP data indicate that the unwinding of this stockpiling and mitigation activity likely had an opposite, dampening, effect on economic growth in 2019-Q2.

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

In 2019, modestly increasing real wages and an expansionary fiscal policy are expected to continue to support moderate private consumption growth. Business investment growth is projected to remain weak as uncertainty persists over the nature of the UK's future trading relationship with the EU. At the same time, total investment will be supported by strong public investment in 2019. Net exports are expected to continue to contribute negatively to growth due to subdued external demand. Reflecting these factors and the technical assumption about UK trade relations with the EU27, GDP growth is forecast to be 1.3% in 2019.

In 2020, GDP growth is projected to be stable at 1.3%, as an expected improvement in the contribution of net trade to growth is forecast to be offset by slower domestic demand growth. Government and private consumption growth are expected to moderate in 2020, in line with somewhat tighter fiscal policy, while investment growth is expected to remain weak.



Consumer price inflation is forecast to ease to 1.8% in 2019 from 2.5% in 2018, partly due to lower oil prices. Inflation is forecast to rebound slightly to 2.0% in 2020 reflecting, in part, sustained wage pressures.

## STATISTICAL ANNEX

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

	5-year averages							Summer 2019 forecast		Spring 2019 forecast		2.7.2019
	2000-04	2005-09	2010-14	2015	2016	2017	2018	2019	2020	2019	2020	
Belgium	2.1	1.3	1.2	1.7	1.5	1.7	1.4	1.2	1.2	1.2	1.2	1.2
Germany	1.0	0.6	2.2	1.7	2.2	2.2	1.4	0.5	1.4	0.5	1.5	
Estonia	7.3	0.9	3.8	1.9	3.5	4.9	3.9	2.9	2.3	2.8	2.4	
Ireland	6.0	1.2	3.1	25.1	5.0	7.2	6.7	4.0	3.4	3.8	3.4	
Greece	4.6	0.9	-4.9	-0.4	-0.2	1.5	1.9	2.1	2.2	2.2	2.2	
Spain	3.7	1.8	-0.9	3.6	3.2	3.0	2.6	2.3	1.9	2.1	1.9	
France	2.1	0.8	1.2	1.1	1.1	2.3	1.7	1.3	1.4	1.3	1.5	
Italy	1.5	-0.5	-0.4	0.9	1.1	1.7	0.9	0.1	0.7	0.1	0.7	
Cyprus	4.3	3.2	-1.7	2.0	4.8	4.5	3.9	2.9	2.6	3.1	2.7	
Latvia	7.1	2.4	2.1	3.0	2.1	4.6	4.8	3.0	2.8	3.1	2.8	
Lithuania	6.8	2.4	3.7	2.0	2.4	4.1	3.5	3.1	2.4	2.7	2.4	
Luxembourg	3.9	2.1	3.0	3.9	2.4	1.5	2.6	2.4	2.6	2.5	2.6	
Malta	2.6	2.1	4.2	10.8	5.6	6.8	6.7	5.3	4.8	5.5	4.8	
Netherlands	1.8	1.5	0.6	2.0	2.2	2.9	2.6	1.6	1.5	1.6	1.6	
Austria	2.0	1.4	1.2	1.1	2.0	2.6	2.7	1.5	1.5	1.5	1.6	
Portugal	1.5	0.4	-0.9	1.8	1.9	2.8	2.1	1.7	1.7	1.7	1.7	
Slovenia	3.6	2.3	0.2	2.3	3.1	4.9	4.5	3.2	2.8	3.1	2.8	
Slovakia	3.9	5.1	2.7	4.2	3.1	3.2	4.1	3.6	3.3	3.8	3.4	
Finland	3.2	0.8	0.5	0.5	2.8	3.0	1.7	1.5	1.2	1.6	1.2	
Euro area	2.0	0.7	0.8	2.1	1.9	2.4	1.9	1.2	1.4	1.2	1.5	
Bulgaria	5.2	4.7	1.1	3.5	3.9	3.8	3.1	3.3	3.4	3.3	3.4	
Czechia	3.5	3.3	1.1	5.3	2.5	4.4	3.0	2.6	2.5	2.6	2.4	
Denmark	1.6	0.3	1.2	2.3	2.4	2.3	1.5	1.7	1.6	1.7	1.6	
Croatia	4.4	1.7	-0.9	2.4	3.5	2.9	2.6	3.1	2.7	2.6	2.5	
Hungary	4.3	0.5	1.4	3.5	2.3	4.1	4.9	4.4	2.8	3.7	2.8	
Poland	3.3	4.7	3.0	3.8	3.1	4.8	5.1	4.4	3.6	4.2	3.6	
Romania	5.2	4.6	1.4	3.9	4.8	7.0	4.1	4.0	3.7	3.3	3.1	
Sweden	3.0	1.0	2.4	4.5	2.7	2.1	2.4	1.7	1.5	1.4	1.6	
EU27	2.1	0.9	0.9	2.3	2.1	2.6	2.1	1.4	1.6	1.4	1.7	
United Kingdom	2.9	0.7	2.0	2.3	1.8	1.8	1.4	1.3	1.3	1.3	1.3	
EU28	2.2	0.9	1.1	2.3	2.0	2.5	2.0	1.4	1.6	1.4	1.6	

Table 2: Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter, 2018-2020)

	2018/1	2018/2	2018/3	2018/4	2019/1	2019/2	2019/3	2019/4	2020/1	2020/2	2020/3	2020/4	2.7.2019
Belgium	0.3	0.3	0.3	0.4	0.3	0.2	0.2	0.3	0.3	0.3	0.3	0.3	
Germany	0.4	0.5	-0.2	0.0	0.4	-0.1	0.2	0.3	0.2	0.2	0.2	0.2	
Estonia	0.1	1.7	0.2	2.1	0.5	0.2	0.2	0.3	0.7	0.7	0.7	0.7	
Ireland	-0.5	2.1	0.9	0.1	1.4	1.2	0.9	0.9	0.8	0.8	0.8	0.8	
Greece	0.5	0.2	0.9	-0.1	0.2	:	:	:	:	:	:	:	
Spain	0.6	0.6	0.5	0.6	0.7	0.6	0.5	0.5	0.5	0.5	0.5	0.5	
France	0.3	0.2	0.3	0.4	0.3	0.3	0.3	0.4	0.3	0.3	0.3	0.3	
Italy	0.2	0.0	-0.1	-0.1	0.1	0.0	0.1	0.2	0.2	0.2	0.2	0.2	
Cyprus	1.1	0.8	0.9	0.9	0.7	:	:	:	:	:	:	:	
Latvia	2.0	1.0	1.4	0.9	-0.1	0.9	0.9	0.8	0.7	0.6	0.6	0.6	
Lithuania	0.9	0.9	0.4	1.4	1.0	0.5	0.4	0.9	0.5	0.5	0.5	0.5	
Luxembourg	0.5	0.2	0.4	0.6	0.3	:	:	:	:	:	:	:	
Malta	2.1	2.2	2.9	0.3	-0.6	:	:	:	:	:	:	:	
Netherlands	0.6	0.6	0.2	0.5	0.5	0.3	0.4	0.4	0.4	0.4	0.4	0.4	
Austria	0.9	0.5	0.3	0.3	0.4	0.3	0.4	0.4	0.4	0.3	0.3	0.3	
Portugal	0.5	0.6	0.3	0.4	0.5	0.4	0.4	0.4	0.5	0.4	0.4	0.4	
Slovenia	0.7	0.8	1.3	0.7	0.8	0.5	0.6	0.7	0.7	0.7	0.7	0.7	
Slovakia	1.0	1.1	1.0	0.8	0.9	0.6	0.7	0.6	0.9	0.8	0.9	0.8	
Finland	0.4	0.2	0.1	0.0	0.6	0.3	0.3	0.3	0.3	0.2	0.2	0.2	
Euro area	0.4	0.4	0.1	0.2	0.4	0.2	0.3	0.4	0.3	0.3	0.3	0.3	
Bulgaria	0.9	0.8	0.7	0.8	1.2	0.6	0.8	0.8	0.8	0.8	0.8	0.9	
Czechia	0.6	0.6	0.6	0.9	0.6	0.6	0.7	0.6	0.6	0.7	0.6	0.5	
Denmark	0.8	0.6	0.3	0.8	0.1	0.3	0.4	0.4	0.4	0.4	0.4	0.4	
Croatia	0.4	1.2	0.6	0.2	1.8	0.6	-0.1	0.3	1.0	0.9	0.9	0.8	
Hungary	1.2	1.1	1.5	1.1	1.5	0.9	0.4	0.4	0.8	0.8	0.8	0.8	
Poland	1.4	1.2	1.5	0.5	1.5	1.0	1.3	1.0	0.8	0.7	0.7	0.7	
Romania	0.3	1.2	1.5	1.0	1.3	0.4	0.5	1.1	1.0	0.8	0.9	1.2	
Sweden	0.9	0.3	-0.1	1.2	0.6	0.2	0.2	0.2	0.5	0.5	0.5	0.5	
EU27	0.5	0.5	0.2	0.3	0.5	0.2	0.4	0.4	0.4	0.4	0.3	0.3	
United Kingdom	0.1	0.4	0.7	0.2	0.5	0.0	0.4	0.3	0.4	0.3	0.3	0.3	
EU28	0.4	0.4	0.3	0.3	0.5	0.2	0.4	0.4	0.4	0.4	0.3	0.3	

	Harmonised index of consumer prices (percentage change on preceding year, 2000-2020)								2.7.2019		
	5-year averages							Summer 2019 forecast		Spring 2019 forecast	
	2000-04	2005-09	2010-14	2015	2016	2017	2018	2019	2020	2019	2020
<b>Belgium</b>	2.0	2.2	2.0	0.6	1.8	2.2	2.3	<b>1.6</b>	<b>1.6</b>	1.8	1.6
<b>Germany</b>	1.5	1.8	1.6	0.7	0.4	1.7	1.9	<b>1.4</b>	<b>1.3</b>	1.5	1.5
<b>Estonia</b>	3.5	5.2	3.2	0.1	0.8	3.7	3.4	<b>2.4</b>	<b>2.1</b>	2.4	2.2
<b>Ireland</b>	4.1	1.8	0.5	0.0	-0.2	0.3	0.7	<b>1.1</b>	<b>1.3</b>	1.0	1.3
<b>Greece</b>	3.4	3.1	1.3	-1.1	0.0	1.1	0.8	<b>0.8</b>	<b>0.8</b>	0.8	0.8
<b>Spain</b>	3.2	2.7	1.8	-0.6	-0.3	2.0	1.7	<b>0.9</b>	<b>1.2</b>	1.1	1.4
<b>France</b>	2.0	1.7	1.6	0.1	0.3	1.2	2.1	<b>1.3</b>	<b>1.4</b>	1.3	1.4
<b>Italy</b>	2.5	2.1	1.9	0.1	-0.1	1.3	1.2	<b>0.8</b>	<b>1.0</b>	0.9	1.1
<b>Cyprus</b>	3.1	2.2	1.9	-1.5	-1.2	0.7	0.8	<b>0.5</b>	<b>0.9</b>	0.9	1.1
<b>Latvia</b>	3.2	8.4	1.2	0.2	0.1	2.9	2.6	<b>3.1</b>	<b>2.5</b>	2.8	2.4
<b>Lithuania</b>	0.6	5.5	2.0	-0.7	0.7	3.7	2.5	<b>2.2</b>	<b>2.1</b>	2.1	2.1
<b>Luxembourg</b>	2.8	2.7	2.4	0.1	0.0	2.1	2.0	<b>1.7</b>	<b>1.6</b>	1.8	1.7
<b>Malta</b>	2.6	2.5	1.9	1.2	0.9	1.3	1.7	<b>1.8</b>	<b>1.9</b>	1.8	1.9
<b>Netherlands</b>	3.0	1.6	1.8	0.2	0.1	1.3	1.6	<b>2.5</b>	<b>1.4</b>	2.5	1.5
<b>Austria</b>	1.8	1.9	2.3	0.8	1.0	2.2	2.1	<b>1.7</b>	<b>1.7</b>	1.8	1.9
<b>Portugal</b>	3.3	1.9	1.6	0.5	0.6	1.6	1.2	<b>0.9</b>	<b>1.5</b>	1.1	1.6
<b>Slovenia</b>	6.9	3.0	1.8	-0.8	-0.2	1.6	1.9	<b>1.7</b>	<b>2.0</b>	1.8	2.1
<b>Slovakia</b>	7.8	2.8	2.0	-0.3	-0.5	1.4	2.5	<b>2.4</b>	<b>2.3</b>	2.4	2.3
<b>Finland</b>	1.8	1.8	2.3	-0.2	0.4	0.8	1.2	<b>1.4</b>	<b>1.6</b>	1.4	1.6
<b>Euro area</b>	2.2	2.0	1.7	0.2	0.2	1.5	1.8	<b>1.3</b>	<b>1.3</b>	1.4	1.4
<b>Bulgaria</b>	6.4	7.1	1.5	-1.1	-1.3	1.2	2.6	<b>2.4</b>	<b>1.7</b>	2.0	1.8
<b>Czechia</b>	2.5	2.7	1.7	0.3	0.6	2.4	2.0	<b>2.4</b>	<b>2.1</b>	2.4	2.0
<b>Denmark</b>	2.1	2.0	1.6	0.2	0.0	1.1	0.7	<b>1.0</b>	<b>1.4</b>	1.3	1.5
<b>Croatia</b>	3.2	3.4	1.8	-0.3	-0.6	1.3	1.6	<b>0.9</b>	<b>1.0</b>	1.0	1.2
<b>Hungary</b>	7.1	5.1	3.2	0.1	0.4	2.4	2.9	<b>3.2</b>	<b>3.2</b>	3.2	3.2
<b>Poland</b>	4.3	2.8	2.2	-0.7	-0.2	1.6	1.2	<b>2.1</b>	<b>2.7</b>	1.8	2.5
<b>Romania</b>	26.0	6.8	4.0	-0.4	-1.1	1.1	4.1	<b>4.2</b>	<b>3.7</b>	3.6	3.0
<b>Sweden</b>	1.9	1.9	1.0	0.7	1.1	1.9	2.0	<b>1.7</b>	<b>1.6</b>	1.5	1.6
<b>EU27</b>	2.6	2.3	1.8	0.1	0.2	1.6	1.8	<b>1.5</b>	<b>1.5</b>	1.5	1.6
<b>United Kingdom</b>	1.2	2.5	2.9	0.0	0.7	2.7	2.5	<b>1.8</b>	<b>2.0</b>	2.0	2.1
<b>EU28</b>	2.7	2.3	2.0	0.1	0.2	1.7	1.9	<b>1.5</b>	<b>1.6</b>	1.6	1.7

	Harmonised index of consumer prices (percentage change on preceding year, 2018-2020)												2.7.2019
	2018/1	2018/2	2018/3	2018/4	2019/1	2019/2	2019/3	2019/4	2020/1	2020/2	2020/3	2020/4	
<b>Belgium</b>	1.6	2.2	2.7	2.8	2.0	1.6	1.4	1.1	1.7	1.6	1.6	1.5	
<b>Germany</b>	1.5	1.9	2.2	2.1	1.6	1.6	1.1	1.3	1.4	1.2	1.3	1.3	
<b>Estonia</b>	3.2	3.3	3.5	3.7	2.3	2.9	2.2	2.2	2.4	2.2	2.0	1.9	
<b>Ireland</b>	0.5	0.4	1.0	0.9	0.9	1.2	0.9	1.2	1.2	1.2	1.3	1.4	
<b>Greece</b>	0.3	0.7	0.9	1.1	0.8	0.7	0.8	0.9	1.0	1.0	0.7	0.5	
<b>Spain</b>	1.1	1.8	2.3	1.8	1.1	1.1	0.7	0.9	1.2	1.1	1.3	1.4	
<b>France</b>	1.5	2.1	2.6	2.2	1.4	1.3	1.1	1.3	1.5	1.4	1.3	1.3	
<b>Italy</b>	0.9	1.0	1.7	1.5	1.0	0.9	0.8	0.6	0.8	0.8	1.1	1.1	
<b>Cyprus</b>	-0.8	0.8	1.6	1.5	1.3	0.6	0.1	0.4	0.8	0.7	1.1	1.2	
<b>Latvia</b>	2.0	2.4	2.9	2.9	2.8	3.3	3.3	2.9	2.9	2.4	2.4	2.4	
<b>Lithuania</b>	3.1	2.5	2.2	2.3	2.1	2.6	2.2	2.1	2.1	2.1	2.1	2.1	
<b>Luxembourg</b>	1.2	1.9	2.5	2.4	2.1	2.0	1.5	1.5	1.8	1.4	1.6	1.7	
<b>Malta</b>	1.3	1.7	2.4	1.6	1.2	1.7	2.1	2.0	1.8	2.0	2.1	1.6	
<b>Netherlands</b>	1.3	1.5	1.8	1.8	2.5	2.7	2.3	2.4	1.5	1.4	1.3	1.4	
<b>Austria</b>	2.0	2.1	2.2	2.1	1.6	1.8	1.6	1.7	1.7	1.6	1.7	1.7	
<b>Portugal</b>	0.9	1.2	1.8	0.8	0.8	0.6	0.9	1.2	1.3	1.4	1.5	1.6	
<b>Slovenia</b>	1.5	2.1	2.1	2.0	1.3	1.7	1.8	1.9	2.2	1.9	2.0	2.0	
<b>Slovakia</b>	2.4	2.9	2.7	2.1	2.4	2.6	2.4	2.4	2.3	2.4	2.4	2.4	
<b>Finland</b>	0.8	1.0	1.4	1.5	1.2	1.3	1.5	1.5	1.5	1.6	1.7	1.7	
<b>Euro area</b>	1.3	1.7	2.1	1.9	1.4	1.4	1.1	1.2	1.3	1.2	1.3	1.3	
<b>Bulgaria</b>	1.6	2.4	3.6	3.0	2.5	2.8	2.0	2.4	2.5	1.8	1.4	1.3	
<b>Czechia</b>	1.7	2.1	2.3	1.8	2.3	2.3	2.2	2.7	2.2	2.1	2.2	2.1	
<b>Denmark</b>	0.5	0.9	0.7	0.7	1.2	0.8	1.0	1.2	1.3	1.3	1.5	1.6	
<b>Croatia</b>	1.1	1.8	2.0	1.3	0.8	0.9	0.9	1.1	1.0	1.0	1.0	1.0	
<b>Hungary</b>	2.0	2.8	3.5	3.3	3.2	3.8	3.0	3.0	3.5	2.8	3.1	3.2	
<b>Poland</b>	1.0	1.1	1.4	1.1	1.2	2.2	2.5	2.6	3.1	2.5	2.5	2.6	
<b>Romania</b>	3.7	4.5	4.6	3.5	3.8	4.4	4.2	4.1	3.9	3.5	3.6	3.8	
<b>Sweden</b>	1.7	2.0	2.2	2.2	1.9	2.0	1.4	1.6	1.7	1.5	1.6	1.7	
<b>EU27</b>	1.3	1.8	2.2	1.9	1.5	1.5	1.3	1.4	1.5	1.4	1.5	1.5	
<b>United Kingdom</b>	2.7	2.4	2.5	2.3	1.8	2.0	1.7	1.7	1.8	2.0	2.0	2.2	
<b>EU28</b>	1.5	1.9	2.2	2.0	1.6	1.6	1.4	1.4	1.5	1.5	1.6	1.6	

### Box 1: Some technical elements behind the forecast

The summer 2019 interim forecast provides an update of the outlook of the spring 2019 forecast of 7 May 2019 and focuses on GDP and inflation developments in all EU Member States.

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

The cut-off date for taking new information into account in this forecast was 2 July 2019.

#### ESA 2010

The source for all tables is the European Commission, unless otherwise stated. Historical data for the Member States are based on the European System of Accounting (ESA 2010). 2019 and 2020 are forecast years.

#### External assumptions

This forecast is based on a set of external assumptions, reflecting market expectations at the time of the forecast. To shield the assumptions from possible volatility during any given trading day, averages from a 10-day reference period (between 17 and 28 June) were used for exchange and interest rates, and for oil prices.

The technical assumption regarding exchange rates was standardised using fixed nominal exchange rates for all currencies. This technical assumption leads to an implied average USD/EUR rate of 1.13 in 2019 and 2020. The average JPY/EUR is 123.14 in 2019 and 121.98 in 2020.

Interest rate assumptions are market-based. Short-term interest rates for the euro area are derived from futures contracts. Long-term interest rates for the euro area, as well as short- and long-term interest rates for other Member States are calculated using implicit forward swap rates, corrected for the current spread between the interest rate and swap rate. In cases where no market instrument is available, the fixed spread vis-à-vis the euro area interest rate is taken for both short- and long-term rates. As a result, short-term interest rates are assumed to be -0.3% in 2019 and -0.5% in 2020 in the euro area. Long-term euro area interest rates are assumed to average -0.2% in 2019 and 2020.

Commodity price assumptions are also based on market conditions. According to futures markets, prices for Brent oil are projected to be on average 64.7 USD/bbl in 2019 and 61.5 USD/bbl in 2020. This would correspond to an oil price of 57.2 EUR/bbl in 2019 and 54.4 in 2020.

#### Trade policies

This forecast is published against a background of elevated trade tensions. The forecast pencils in only the measures that have been implemented until the cut-off date. Compared to the spring forecast, there were a number of changes to the baseline scenario:

- On 10/05/2019, despite ongoing trade negotiations between the US and China, the US further raised tariffs from 10% to 25% on 200 billion USD of Chinese imports already targeted by new tariffs in September 2018. China reacted by raising tariffs from 10% up to 25% on 60 billion USD of imports from the US.
- On 17/05/2019, the US agreed to remove steel and aluminium tariffs on Canada and Mexico,

**Table 1:  
Technical assumptions**

	Summer 2019			Spring 2019	
	interim forecast		2020	2019	2020
3-month EURIBOR (percentage per annum)	-0.3	<b>-0.3</b>	<b>-0.5</b>	-0.3	-0.3
10-year government bond yields (percentage per annum) (a)	0.4	<b>-0.2</b>	<b>-0.2</b>	0.1	0.2
USD/EUR exchange rate	1.18	<b>1.13</b>	<b>1.13</b>	1.13	1.13
JPY/EUR exchange rate	130.38	<b>123.14</b>	<b>121.98</b>	125.57	125.73
GBP/EUR exchange rate	0.88	<b>0.88</b>	<b>0.89</b>	0.86	0.86
EUR nominal effective exchange rate (annual percentage change) (b)	4.8	<b>-0.9</b>	<b>0.3</b>	-1.6	-0.1
Oil price (USD per barrel)	71.5	<b>64.7</b>	<b>61.5</b>	69.2	67.8
Oil price (EUR per barrel)	60.7	<b>57.2</b>	<b>54.4</b>	61.3	60.2

(a) 10-year government bond yields for the euro area equal the German government bond yields.

(b) 42 industrial countries EU-28, TR CH NR US CA JP AU MX NZ KO CN HK RU BR.

(Continued on the next page)

Box (continued)

- removing an important obstacle for the ratification of the renegotiated NAFTA trade deal (United States-Mexico-Canada, USMCA).
- After an investigation under Section 232 of the Trade Expansion Act of 1962 into whether automotive imports into the US threaten national security, the US secretary of commerce recommended actions to adjust automotive imports. The US President decided on 17/05/2019 to give the US trade representative six months to negotiate an agreement with the involved countries if no agreement is reached, the US President can decide to impose tariffs.
- On 31/05/2019, the US announced that it will withdraw preferential market access for India. India reacted by taking rebalancing measures against the steel and aluminium tariffs, which the US had introduced in March.

#### Working-day adjustment

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

The working-day effect in the EU and the euro area is estimated to be limited in 2019, implying that working-day adjusted and unadjusted annual growth rates differ only marginally. In 2020, this effect is positive and lifts the unadjusted growth rate by about ¼ pps. in the euro area.

#### Geographical zones

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

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

EU27: EU28 without UK.

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