

2016 YEAR-END OUTLOOK ON THE EURO AREA ECONOMIES IN 2016-2017



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ABOUT THE EBF ECONOMIC OUTLOOK

This bi-annual report is prepared by the members of the European Banking Federation's Chief Economist Group, comprising the chief economists of leading European banks and banking associations. This report reflects a consensus on the outlook for the euro area economy that is based on arithmetic averages.

ABOUT THE EUROPEAN BANKING FEDERATION

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.5 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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OUR FORECAST FOR THE EURO AREA

- **The European economy is slowly but steadily working its way out of the crisis.** We foresee the euro area GDP growing by 1.7 percent this year and by 1.5 percent in 2017.
- **European banks see a gradual recovery of inflation ahead.** We expect consumer price inflation to average 0.2 percent in 2016, before a substantial rise to 1.2 percent in 2017.
- **Public finances will continue to adjust slowly:** the euro area general government budget deficit will be 2.1 percent of GDP this year, and 1.8 percent of GDP in 2017.
- **The expected GDP growth will continue generating a gradual fall in unemployment.** The jobless rate is forecast to be 10.1 percent in 2016 and 9.7 percent in 2017.
- We expect the ECB main interest rates to remain at lower levels next year.

THE CHIEF ECONOMIST GROUP CONSENSUS

The European economy is slowly but steadily working its way out of the crisis. A 0.6 percent growth rate in the first quarter of 2016 brought the euro area economy slightly above its pre-crisis peak. This also marked, for the first time since 2011, a better economic performance by the euro area than that of the European Union (EU-28)

The euro area economy will continue to expand slowly as the Chief Economist Group of the European Banking Federation expects the euro area to grow by 1.7 percent in 2016.

Similar to the years preceding the financial crisis, private consumption is nowadays the engine of growth in Europe reaching pre-crisis levels. After falling significantly as a result of protracted uncertainty in the euro area in 2012, we expect private consumption to continue its gradual improvement growing by 1.8 in 2016 and in 2017, albeit at a slower pace, by 1.5 percent. Our forecast expects investment to grow by 2.9 percent in 2016 with a slight deceleration in 2017, growing by 2.7 percent.

Inflation is still very low by historic standards, averaging zero in 2015. While still currently below the ECB target of nearly 2%, inflation is currently slowly increasing leaving behind concerns of possible deflation. Our forecast sees inflation averaging 0.2 percent in 2016, before a rise to 1.2 percent in 2017. This scenario suggests that inflation will remain below the ECB target of price stability, albeit progressively converging towards this target due to expected higher commodity prices and benign economic situations. We foresee the rate of core inflation (which excludes volatile items like commodities, energy and non-processed food) to be 0.8 percent in 2016 and 1.0 percent in 2017.

We now expect exports to grow by 2.9 percent this year and slightly strengthen throughout 2017 when we expect a 3.3 percent growth.

Furthermore, the possible increase of interest rates by the Federal Reserve in 2017, may lead to a slight appreciation of the dollar against the euro. The Chief Economist Group's consensus forecast for the euro/dollar exchange rate in 2017 is 1.07 (see change in table) with a relative wide margin between 0.95 and 1.15.

Labour market conditions are forecast to continue with a moderate improvement supported by the moderate economic growth. After stabilising at 10.9 percent in 2015, our forecast for the euro area projects unemployment at 10.1 percent in 2016, with a slight improvement to 9.7 percent, in 2017. These figures will continue to mask uneven rates across the euro area countries in which the unemployment rate remains high.

The high unemployment is expected to keep wage pressures contained. Our consensus expects wages to increase by 1.2 percent in 2016 and a slightly higher 1.5 percent in 2017.

Oil prices fell by some 60% between July 2014 and January 2015, before only very slightly recovering in 2015 and slightly dipping back in the first months of 2016. Our consensus forecast for the oil price (Brent) in 2017 is around 55\$.

Monetary policy, low inflation and investment pick-up in particular - should President Juncker's plan begin to materialise - will continue to play a major role in the recovery of the European Union economy. On the other hand, the heavy political agenda in Europe in 2017, political uncertainty around Brexit, rising geopolitical tension, a possible materialisation of China's slowdown as well as the lack of structural reforms could impair the growth outlook for the region going forward. We expect the euro area economy to decelerate slightly and expand by 1.5 percent in 2017.

Table: Main indicators of CEG consensus					
y-o-y growth rates unless specified otherwise, in %					
	2013	2014	2015	2016p	2017p
<i>Gross Domestic Product</i>	-0.4	0.8	2.0	1.7	1.5
<i>Private consumption</i>	-0.7	0.9	1.8	1.8	1.5
<i>Public consumption</i>	0.1	0.7	1.4	1.5	1.1
<i>Gross fixed investment (GFCF)</i>	-3.1	0.9	3.2	2.9	2.7
<i>Exports</i>	1.4	3.6	6.5	2.9	3.3
<i>Imports</i>	0.4	3.6	6.4	3.4	3.6
<i>Unemployment rate</i>	12.0	11.6	10.9	10.1	9.7
<i>Prices (HCPI)</i>	1.4	0.4	0.0	0.2	1.2
<i>General Government balance (% of GDP)</i>	-2.9	-2.4	-2.1	-2.1	-1.8
<i>General Government debt (% of GDP)</i>	95.1	94.3	92.6	92.1	89.0

Source: current EBF projections for 2016 and 2017; European Commission data for previous years.

RISK TO THE SCENARIO

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

A) UPSIDE RISK

- + Short-term positive effects in the event of a U.S. loosening fiscal policy and deregulation after President-elect Trump takes office. Growth at international level would benefit if President-elect Trump holds from introducing tariffs on imports and clashing with international treaties.
- + The President Juncker's Investment Plan for Europe may start generating effects in the economy, thus supporting the euro area growth in 2017.

B) DOWNSIDE RISKS

- The high degree of uncertainty due to the political risk in Europe with several countries holding elections in 2017, ongoing Brexit negotiations, and further escalation in global geopolitical tension, is a substantial factor that could impact the economic performance of the euro area.
- The possible increase in the federal funds rate by the U.S. Federal Reserve in 2017 may cause financial markets' volatility.
- The slowdown of the Chinese economy could materialise in 2017 which would, inter alia, affect the euro area's trade exposure and investment to China.
- Global trade would be harmed if the upcoming Trump administration takes swift actions such as activation of protectionist measures. An aggressive US trade policy would affect slowdown in China's growth (previous point).

The risks to the growth outlook are according to the Chief Economist Group tilted to the downside

ANNEX 1:

YEAR-END POLL ON THE EURO AREA ECONOMIC OUTLOOK FOR 2016

TABLE 1		2013	2014	2015	CEG Consensus 2016			
					2016 mean	2016 range		
1. Output and aggregate demand:								
(Ann.% change)								
	Gross domestic product (GDP)	-0.3	1.2	2.0	1.7	1.4	3.3	
	Private consumption	-0.6	-0.6	1.8	1.8	1.2	3.4	
	Public consumption	0.2	0.0	1.4	1.5	1.1	1.8	
	Gross investment (GFCF)	-2.4	-3.4	3.2	2.9	1.9	4.2	
	Exports	2.1	1.5	6.5	2.9	2.3	5.6	
	Imports	1.2	0.4	6.4	3.4	2.6	5.3	
2. Labour market and prices:								
(Ann.% change)								
	Unemployment rate (%)	12.0	11.6	10.9	10.1	10.0	10.5	
	Wages (Unit Labour Cost)	1.3	1.2	1.2	1.2	0.7	2.0	
	Prices (HCPI)	1.4	0.4	0.0	0.2	-0.3	0.6	
	Core HCPI	1.1	0.8	0.8	0.8	0.4	1.0	
3. Public finances:								
(% GDP)								
	Government Balance	-2.9	-2.6	-2.1	-2.1	-4.6	-1.8	
	Government Debt	93.6	94.3	92.6	92.1	89.8	100.2	
4. External sector:								
(% GDP)								
	Trade Balance	2.2	2.6	4.2	3.5	3.0	4.0	
	Current Account Balance	2.4	2.8	3.3	2.4	-3.6	3.7	
(p.m.) US growth	(Ann.% change)	1.5	2.4	2.6	1.6	1.5	2.0	
(p.m.) Oil price (Brent)	(US\$/bl)	111.8	99.7	52.6	45.4	42.0	50.0	
5. Monetary and financial indicators:								
	Interest rate on ECB's main refinancing operations	June	0.50	0.15	0.05	0.02	-0.40	0.50
		December	0.25	0.05	0.05	-0.05	-0.40	0.75
	3 month interest rate (EURIBOR)	(year-end)	0.27	0.08	-0.13	-0.25	-0.35	0.20
	10 year government bond yield (Bund)	(year-end)	1.94	0.54	0.64	0.19	-0.05	0.40
	M3 growth	(annual growth)	1.0	3.6	4.7	4.65	3.00	5.40
	Credit to private sector (M3 definition)	(annual growth)	-2.4	-0.5	0.8	0.64	-2.10	1.90
	Exchange rate USD/EUR	(year-end)	1.32	1.21	1.09	1.07	0.90	1.11

ANNEX 2:

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

TABLE 2		2013	2014	2015	CEG Consensus 2017			
					2017 mean	2017 range		
1. Output and aggregate demand:								
(Ann.% change)								
	Gross domestic product (GDP)	-0.3	1.2	2.0	1.5	1.2	2.4	
	Private consumption	-0.6	-0.6	1.8	1.5	1.1	2.4	
	Public consumption	0.2	0.0	1.4	1.1	0.8	1.5	
	Gross investment (GFCF)	-2.4	-3.4	3.2	2.7	1.8	3.7	
	Exports	2.1	1.5	6.5	3.3	1.9	4.5	
	Imports	1.2	0.4	6.4	3.6	2.4	5.1	
2. Labour market and prices:								
(Ann.% change)								
	Unemployment rate (%)	12.0	11.6	10.9	9.7	9.5	10.0	
	Wages (Unit Labour Cost)	1.3	1.2	1.2	1.5	0.9	2.2	
	Prices (HCPI)	1.4	0.4	0.0	1.2	0.9	1.6	
	Core HCPI	1.1	0.8	0.8	1.0	0.7	1.2	
3. Public finances:								
(% GDP)								
	Government Balance	-2.9	-2.6	-2.1	-1.8	-3.6	-1.4	
	Government Debt	93.6	94.3	92.6	91.2	89.0	99.5	
4. External sector:								
(% GDP)								
	Trade Balance	2.2	2.6	3.4	3.2	2.5	3.9	
	Current Account Balance	2.4	2.8	3.1	2.4	-3.6	3.6	
(p.m.) US growth	(Ann.% change)	1.5	2.4	2.6	2.2	2.0	2.4	
(p.m.) Oil price (Brent)	(US\$/bl)	111.8	99.7	52.6	54.2	49.0	60.0	
5. Monetary and financial indicators:								
	Interest rate on ECB's main refinancing operations	June	0.50	0.15	0.05	-0.10	-0.40	0.05
		December	0.25	0.05	0.05	-0.07	-0.40	0.50
	3 month interest rate (EURIBOR)	(year-end)	0.27	0.08	-0.13	-0.21	-0.35	0.30
	10 year government bond yield (Bund)	(year-end)	1.94	0.54	0.64	0.53	0.20	1.00
	M3 growth	(annual growth)	1.0	3.6	4.7	4.65	3.00	5.80
	Credit to private sector (M3 definition)	(annual growth)	-2.4	-0.5	0.8	0.98	-0.20	2.20
	Exchange rate USD/EUR	(year-end)	1.32	1.21	1.09	1.08	0.95	1.15