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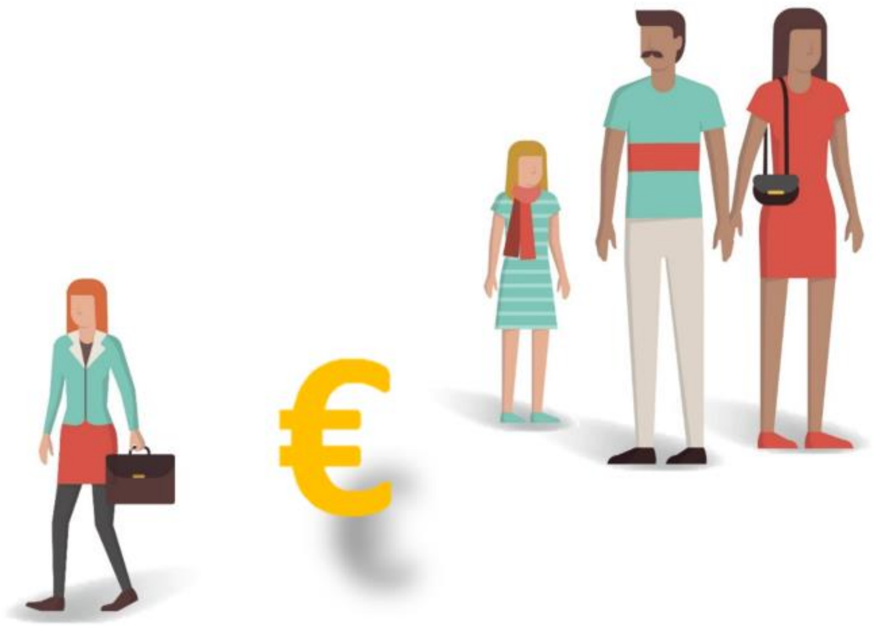
2018 AUTUMN OUTLOOK

ON THE EURO AREA ECONOMY IN 2018-2019

UNCERTAINTY DIMS EURO AREA GROWTH



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ABOUT THE EBF ECONOMIC OUTLOOK

This bi-annual report is prepared with contributions from the European Banking Federation's Chief Economists' 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, which is based on arithmetic averages.

This EBF publication does not necessarily reflect the views of the individual member associations of the Federation.

ABOUT THE EUROPEAN BANKING FEDERATION

The European Banking Federation is the voice of the European banking sector, bringing together national banking associations from 45 countries. The EBF is committed to a thriving European economy that is underpinned by a stable, secure and inclusive financial ecosystem, and to a flourishing society where financing is available to fund the dreams of citizens, businesses and innovators everywhere.

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THE EBF FORECAST FOR THE EURO AREA

- **The Euro area economic growth will continue to expand, albeit at a lower pace.** We foresee the Euro area GDP growing by 2.0 percent in 2018 and by 1.8 percent in 2019.

- **European banks see inflation stabilising.** With our forecast of an inflation rate of 1.8 percent in 2018 and 2019, the ECB's medium-term objective of price stability -below, but close to 2.0 percent- is more or less achieved.

- **Public finances have improved.** The Euro area's general government budget deficit will be 0.6 percent of GDP in 2018, down from 1.0 percent in 2017. In 2019, it will remain about the same level i.e. 0.7 percent of GDP.

- **Labour markets will continue to improve over the forecast horizon.** The jobless rate is forecast to be 8.3 percent in 2018 with a further improvement to 7.9 percent in 2019.

Main indicators of Chief Economists' Group's consensus

year-on-year growth rates unless specified otherwise, in %

	2017	2018p	2019p
Gross domestic product	2.4	*2.0*	*1.8*
Private consumption	1.6	*1.4*	*1.4*
Public consumption	1.2	*1.2*	*1.2*
Gross fixed investment (GFCF)	2.6	*3.3*	*2.6*
Exports	5.2	*4.1*	*4.0*
Imports	3.9	*3.7*	*4.0*
Unemployment rate	9.1	*8.3*	*7.9*
Prices (HICP)	1.5	*1.8*	*1.8*
General Government balance (% of GDP)	-1.0	*-0.6*	*-0.7*
General Government debt (% of GDP)	88.9	*85.5*	*83.6*

Source: Projections for 2018 and 2019 from EBF. European Commission data for previous year.

THE CHIEF ECONOMISTS' GROUP CONSENSUS

The Chief Economists' Group of the European Banking Federation expects economic growth in the Euro area to continue above trend, albeit at a lower pace, and despite lower growth dynamics expected for the next quarters to come. The slowdown in the pace of the economic growth in the 19-country bloc is mainly attributed to temporary country-specific factors and an easing of foreign demand.

The Euro area economy will continue growing in the forecast period benefiting from sustained domestic demand, accommodative monetary and fiscal policies, and strong labour market performance. The main downside risks remain the internal uncertainty illustrated by political jitters in Europe and an external environment with weaker global trade and lingering protectionism.

We expect the Euro area to expand, offsetting uncertainty and tempered global demand, by 2.0 percent in 2018. Growth is expected to cool down slightly in 2019 with a projected GDP growth of 1.8 percent.

DOMESTIC ECONOMY

Domestic demand remains solid, enduring as a major growth driver for the continued expansion of the Euro area economy over the last few years, supported by monetary and fiscal policies.

Private consumption growth is forecast to remain healthy, despite slight moderation, supporting the economic expansion of the Euro area. Private consumption will continue benefiting from continued strong labour market performance, higher real wage growth and supportive financing conditions. We expect private consumption to grow by 1.4 percent both in 2018 and 2019. Public consumption continues to increase. After a slowdown in 2017, public consumption is forecast to rise by 1.2 percent both in 2018 and 2019.

Fixed business investment, measuring corporate investment activity, will also continue its recovery, while supporting domestic demand, benefiting from favorable financing conditions, growing by 3.3 percent in 2018 and moderating throughout 2019 to 2.6 percent growth.

GLOBAL ECONOMY

The global economy is expected to continue expanding over the forecast period, despite losing momentum as the growth pattern across major economies has become more uneven.

While concerns regarding the consequences of US protectionist policies prevail, main trade clash is expected to remain largely between US and China as the US administration has recently renegotiated the North American Free Trade Agreement with Canada and Mexico (renamed USMCA), and the US–Korea Free Trade Agreement. The US administration is also currently engaged in trade agreement talks with the European Union, Japan and the United Kingdom.

A trade conflict with Europe, with the US administation imposing tariffs on a wide range of goods including car tariffs, would severely affect European exports. It remains to be seen what the outcome of trade negotiations between Europe and US will be, given that for the time being, both sides agreed to hold off on new duties following a meeting between the President of the European Commission, Jean-Claude Juncker, and the US President, Donald Trump, over the summer.

Although trade tensions have taken a toll on business confidence, their negative effect on European export growth has so far been contained. If the US and China do not strike a deal, the situation for European exports may deteriorate as this will likely lead to a slowdown in China's economic growth which is a key market for EU exports. We expect exports to grow by 4.1 percent this year outpacing a 3.7 percent growth in imports. In 2019, exports and imports' growth will be 4.0 percent.

The US economy will continue growing robustly on the back of fiscal stimulus in 2018 and 2019, outperforming most other developed countries. With a strong economy having the lowest unemployment level in half a century and booming consumer confidence, the Federal Reserve (Fed) is expected to continue adjusting its monetary policy gradually by increasing interest rates. Nevertheless, the resilience of the US economy has not been negatively affected so far by higher interest rates. The Chief Economists' Group estimates that the US economy will grow by 2.9 percent this year and 2.5 percent in 2019, up from 2.2 percent in 2017.

FISCAL POLICY AND PUBLIC DEBT

Since the financial crisis, the deficit ratio has decreased mainly due to the low interest rate environment and the economic upswing. The Chief Economists' Group foresees the Euro area fiscal position improving to 0.6 percent of GDP, before increasing to 0.7 percent of GDP in 2019.

Improved budgetary policies and economic growth translate into a lower level of government debt reaching a level of 83.6 percent by the end of 2019. Nonetheless, public debt remains at high levels and long-term plans are required to reduce public indebtedness towards more sustainable levels. The recent controversies over Italy's draft budget are of vital importance considering possible contagion risks, making even more complicated the progress on the reinforcement of the EMU construction.

PRICE DEVELOPMENTS AND MONETARY POLICY

With the expansion of the economy over the last 22 quarters (on average 0.5 percent quarter on quarter), with growing employment (lowest unemployment levels seen since 2008), and with the ECB's massive stimulus to boost growth and inflation in the Euro area, the ECB's objective of price stability - below, but close to 2.0 percent- has been reached since May this year; six months in a row with most recently 2.2 percent.

A key factor of the inflation rate is the price of oil, which together with the price of energy, have substantially increased over the last year. Oil prices fell by some 75 percent during 2014 and 2015, to reach in 2018 their highest levels since November 2014 amid geopolitical tensions, namely the US sanctions on Iran. Since then, prices have collapsed amid concerns over an oversupplied market. With

OPEC countries expected to take by end-2018 their next policy decisions, our consensus forecast for the price of Brent oil in 2018 is around USD 73 and USD 74 in 2019.

Inflation has only started to rise this year mainly driven by rising oil prices. We expect inflation to increase to 1.8 percent in 2018, up from 1.5 percent in 2017. However, the recent drop in oil prices and the undoubtedly high influence of a volatile oil market on inflation, keep inflation expectations low. Inflation is however expected to remain at 1.8 in 2019.

Core inflation (excluding volatile items like commodities, energy and non-processed food) has remained surprisingly subdued and will only increase in 2019 owing to expected strong domestic demand and a pick up in wages. We forecast core inflation to stay at 1.2 percent in 2018, before rising to 1.4 percent in 2019.

Monetary policy continues to be very accommodative contributing to favourable financial conditions. The ECB expects interest rates to remain at their present historical low levels at least throughtout the summer of 2019, and in any case for as long as necessary.

Given the still moderated inflationary outlook, the Chief Economists' Group expects the ECB to remain cautious in its communication and action. While some countries represented in the Chief Economists' Group consider the ECB's easy monetary policy stance still justified, others recommend the end of deflationary-oriented monetary policy measures such as the QE-Programme (anticipated for December 2018, subject to incoming data about the inflation outlook) and the negative interest rate, as deflation no longer poses a risk to the Euro area economic outlook compared to two years ago when inflation was close to zero.

LABOUR MARKET

Labour market conditions are expected to remain favourable over the forecast horizon driven by the economic steadiness, robust growth dynamics, sustained domestic demand, moderate wage growth and structural reform promoting job creation in some Euro area countries.

Unemployment will probably continue its downtrend over the coming years, albeit at a slower pace. We foresee Euro area unemployment rate at 8.3 percent in 2018, with a further improvement to 7.9 percent in 2019, the lowest level since 2007. These figures will continue, however, to mask uneven rates across the Euro area countries. The still existing slack in the labour markets of different Member States, together with competitive pressures and the accelerating impact of the digitalisation phenomenon, are expected to keep wage pressures contained. Our consensus view is that wages are expected to rise by 1.5 percent in 2018 and a slightly lower 1.4 percent in 2019.

THE EURO

The EUR/USD rate is expected to remain sluggish this year, largely due to market fears over the Euro area economic growth outlook, internal political uncertainty, general USD strength on the back of the US robust performance and interest rate disparities between the US and the rest of the world.

In 2019, the EUR is likely to appreciate against the USD as divergences between Euro area and US business and monetary policy cycles start closing. The Fed will probably end its tightening cycle in 2019, while the ECB is expected to begin the normalisation of its monetary policy by end-2019. Furthermore, the impact of the US fiscal stimulus will start fading, with expectations of a slowdown in the US economy increasing in 2020.

The Chief Economists' Group's consensus forecast for the euro/dollar exchange rate at the end of 2019 is 1.18, with a relatively wide margin between 1.10 and 1.23.

RISK TO THE SCENARIO

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

A) UPSIDE RISKS

+ Soft landing of the US economy accompanied by neutral monetary policy.
+ Stronger than expected domestic demand growth if wage dynamics pick up more decisively.
+ Expansionary fiscal policies in some Euro area countries (which have real budgetary room for manoeuvre), potentially bringing support to Euro area economic growth.
+ Stabilisation of global economic activity leading to slight acceleration of Euro area exports.
+ Succesful political monitoring of the 'Italian risk' and a Brexit outcome that is economically acceptable.

B) DOWNSIDE RISKS

– Escalation of the fiscal conflict in Europe with a clash between the European Commission and Italy -Euro area's third biggest economy- over Italy's government budget plans.

– Worsened trade outlook with further escalation of trade tensions between the US and China triggering a trade battle that would harm the global economy. The Euro area economy, that is relatively highly exposed to external trade, would be severely hit if EU-US trade frictions materialise and US tariffs are imposed on EU sectors.

– Although negotiations between the European Union and the United Kingdom seem to be progressing, as seen by the recent draft agreement on the withdrawal of the United Kingdom from the European Union, the final outcome remains a major concern.

– Further slowdown of global growth with weakened emerging economies.

– Increasing geopolitical tensions having the potential to spark a period of further decline in world trade.

The risks to the growth outlook are tilted to the downside, according to the Chief Economists' Group

ANNEX 1:
AUTUMN POLL ON THE EURO AREA ECONOMIC OUTLOOK FOR 2018

TABLE 1		2017	CEG Consensus 2018			Previous CEG Economic Outlook	European Commission Forecast
			2018 Mean	2018 Range		Spring 2018	Autumn 2018
1. Output and aggregate demand:	(Ann.% change)						
	Gross domestic product (GDP)	2.4	2.0	1.9	2.2	2.4	2.1
	Private consumption	1.6	1.4	0.8	1.7	1.7	1.6
	Public consumption	1.2	1.2	0.3	1.4	1.4	1.3
	Gross investment (GFCF)	2.6	3.3	0.7	4.2	3.7	3.3
	Exports	5.2	4.1	2.9	8.4	4.9	3.3
	Imports	3.9	3.7	2.4	6.4	4.5	3.0
2. Labour market and prices:	(Ann.% change)						
	Unemployment rate (%)	9.1	8.3	8.1	8.4	8.4	8.4
	Wages (Unit Labour Cost)	0.7	1.5	1.1	2.0	1.5	1.6
	Prices (HICP)	1.5	1.8	1.7	2.2	1.5	1.8
	Core HICP		1.2	1.0	1.8	1.2	
3. Public finances:	(% GDP)						
	Government Balance	-1.0	-0.6	-0.9	0.8	-0.09	-0.6
	Government Debt	88.9	85.5	84.0	86.7	87.3	86.9
4. External sector:	(% GDP)						
	Trade Balance	3.6	3.4	2.8	4.0	3.5	3.3
	Current Account Balance	4.0	3.2	2.9	3.5	3.4	3.8
(p.m.) US growth	(Ann.% change)	2.2	2.9	2.8	3.2	2.6	2.9
(p.m.) Oil price (Brent)	(US$/bl)	54.8	73.0	63.0	75.0	66.0	75.1
5. Monetary and financial indicators:							
Interest rate on ECB's main refinancing operations	June	0.00	-0.08	-0.40	0.00	-0.07	
	December	0.00	-0.09	-0.40	0.00	-0.08	
3 month interest rate (EURIBOR)	(year-end)	-0.33	-0.29	-0.36	-0.10	-0.03	
10 year government bond yield (Bund)	(year-end)	0.43	0.56	0.40	1.10	0.96	
M3 growth	(annual growth)	4.6	4.33	4.00	4.60	4.26	
Credit to private sector (M3 definition)	(annual growth)	2.8	3.03	2.40	3.50	2.64	
Exchange rate EUR/USD	(year-end)	1.13	1.16	1.14	1.19	1.24	1.23

ANNEX 2:

AUTUMN POLL ON THE EURO AREA ECONOMIC OUTLOOK FOR 2019

TABLE 2		2017	CEG Consensus 2019			Previous CEG Economic Outlook	European Commission Forecast
			2019 Mean	2019 Range		Spring 2018	Autumn 2018
1. Output and aggregate demand:	(Ann.% change)						
	Gross domestic product (GDP)	2.4	1.8	1.5	2.1	2.1	1.9
	Private consumption	1.6	1.4	1.0	1.7	1.8	1.8
	Public consumption	1.2	1.2	0.3	1.7	1.4	1.6
	Gross investment (GFCF)	2.6	2.6	0.6	4.1	3.4	3.0
	Exports	5.2	4.0	2.5	8.6	3.9	3.5
	Imports	3.9	4.0	2.2	6.6	4.1	3.9
2. Labour market and prices:	(Ann.% change)						
	Unemployment rate (%)	9.1	7.9	7.8	8.0	7.9	7.9
	Wages (Unit Labour Cost)	0.7	1.4	1.0	2.1	1.6	1.2
	Prices (HICP)	1.5	1.8	1.6	2.1	1.5	1.8
	Core HICP		1.4	1.2	1.6	1.5	
3. Public finances:	(% GDP)						
	Government Balance	-1.0	-0.7	-0.9	-0.6	-0.09	-0.8
	Government Debt	88.9	83.6	82.0	85.0	84.9	84.9
4. External sector:	(% GDP)						
	Trade Balance	3.6	2.3	-0.4	3.8	3.3	3.2
	Current Account Balance	4.0	2.9	2.3	3.4	3.3	3.6
(p.m.) US growth	(Ann.% change)	2.2	2.5	2.3	3.0	2.4	2.6
(p.m.) Oil price (Brent)	(US$/bl)	54.8	74.1	63.0	85.0	64.5	80.6
5. Monetary and financial indicators:							
Interest rate on ECB's main	June	0.00	-0.08	-0.40	0.05	0.03	
refinancing operations	December	0.00	0.01	-0.40	0.25	0.17	
3 month interest rate (EURIBOR)	(year-end)	-0.33	-0.06	-0.33	0.50	-0.02	
10 year government bond yield (Bund)	(year-end)	0.43	0.89	0.35	1.37	1.31	
M3 growth	(annual growth)	4.6	4.30	4.00	4.50	4.03	
Credit to private sector (M3 definition)	(annual growth)	2.8	3.08	2.60	3.50	2.71	
Exchange rate EUR/USD	(year-end)	1.13	1.18	1.10	1.23	1.26	1.15