EURO AREA

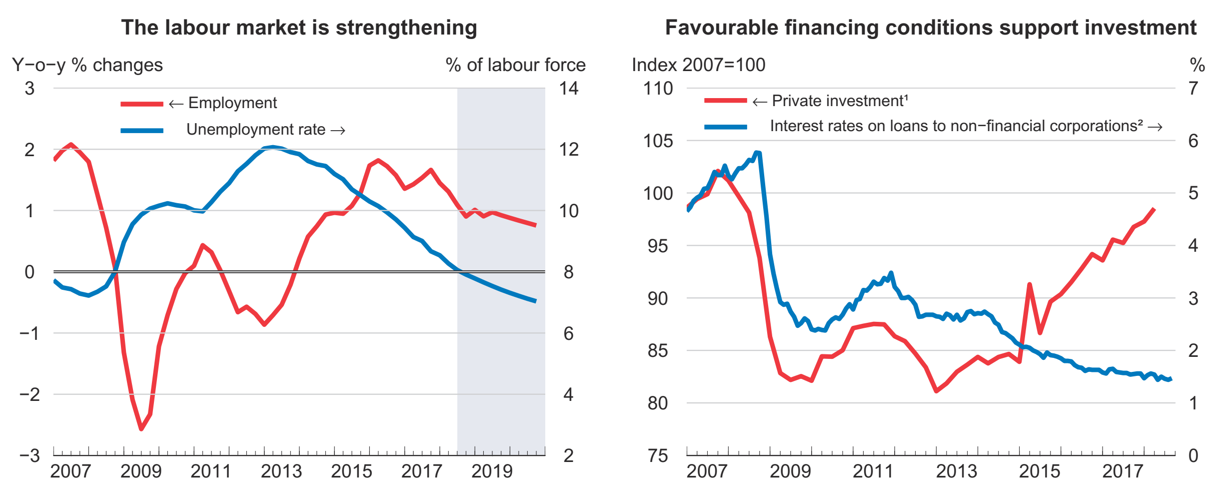
Economic growth is set to moderate, to just above 1½ per cent in 2020. Accommodative monetary policy and some fiscal easing will support domestic demand, in particular private consumption, and employment. Investment will remain reasonably strong, reflecting continued favourable financing conditions and a need to expand capacity. Inflation is projected to rise gradually, as stronger wage growth and dissipating slack translate into sustained increases in core inflation.

Monetary policy should be firmly committed to remaining accommodative as long as needed to attain the inflation objective, while preparing for a gradual normalisation. The euro area fiscal stance is projected to be slightly expansionary in 2018-20. As the expansion continues, governments should improve their fiscal positions and reduce debt. Improving skills, reforming product markets, completing the single market for goods and services, and progress with the banking union, are the best guarantee for stronger, more resilient and inclusive growth.

The expansion continues

Domestic demand continues to support growth, compensating for uncertainties weighing on global trade. Private consumption has slowed, as inflation has picked up and reduced households' purchasing power, but remains resilient owing to strong employment growth. Capital spending remains solid, supported by favourable financing conditions, robust confidence and the need, in some countries, to expand productive capacity. The recovery in residential investment moderated in 2018, despite continuing support from favourable financing conditions and rising incomes. Export growth has weakened this year, following a strong performance in 2017, as uncertainties in global trade increased.

Euro area



1. Private investment is obtained as gross fixed capital formation of the total economy minus government fixed capital formation (appropriation account), deflated by the GDP deflator.
2. New business loans to non-financial corporations in the euro area (19 countries); loans other than revolving loans and overdrafts, convenience and extended credit card debt, with an initial rate fixation period of less than one year.

Source: OECD Economic Outlook 104 database; and European Central Bank, Statistical Data Warehouse.

StatLink http://dx.doi.org/10.1787/888933876594

Euro area: **Demand, output and prices**

	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2015 prices)				
GDP at market prices	10 502.7	1.9	2.5	1.9	1.8	1.6
Private consumption	5 726.7	1.9	1.7	1.4	1.6	1.5
Government consumption	2 167.9	1.9	1.2	1.1	1.5	1.1
Gross fixed capital formation	2 103.3	3.9	2.8	3.4	3.1	2.8
Final domestic demand	9 997.9	2.3	1.8	1.8	1.9	1.7
Stockbuilding[1]	32.8	0.0	-0.1	0.0	0.0	0.0
Total domestic demand	10 030.7	2.3	1.8	1.8	1.9	1.7
Net exports[1]	472.1	-0.4	0.8	0.2	0.0	0.0
Memorandum items						
GDP deflator	_	0.8	1.1	1.5	1.8	1.9
Harmonised index of consumer prices	_	0.2	1.5	1.8	1.9	1.9
Harmonised index of core inflation[2]	_	0.8	1.0	1.0	1.5	1.8
Unemployment rate (% of labour force)	_	10.0	9.1	8.2	7.6	7.2
Household saving ratio, net (% of disposable income)	_	6.1	5.7	5.6	5.6	5.6
General government financial balance (% of GDP)	_	-1.6	-1.0	-0.7	-0.8	-0.5
General government gross debt (% of GDP)	_	109.0	105.3	103.5	102.0	100.2
General government debt, Maastricht definition (% of GDP)	_	91.3	88.9	87.1	85.6	84.1
Current account balance (% of GDP)	_	3.5	3.9	3.8	3.6	3.6

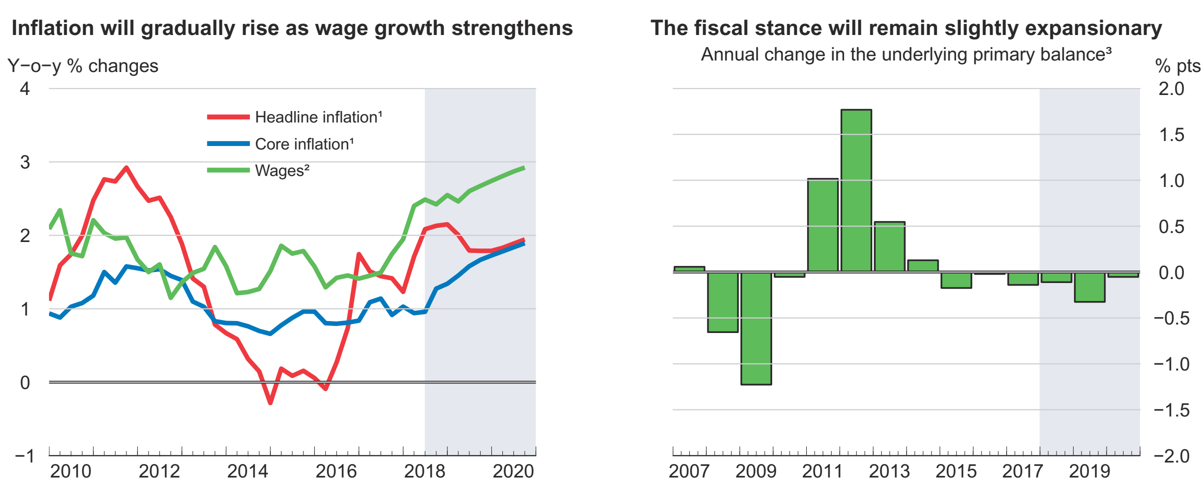
Note : Aggregation based on euro area countries that are members of the OECD, and on seasonally-adjusted and calendar-days-adjusted basis.

1. Contributions to changes in real GDP, actual amount in the first column.
2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 104 database.

StatLink http://dx.doi.org/10.1787/888933877658

Euro area



1. Harmonised consumer price indices, net of energy and food products for core inflation.
2. Nominal wages per employee.
3. Measured in per cent of potential GDP.

Source: OECD Economic Outlook 104 database.

StatLink http://dx.doi.org/10.1787/888933876613

Labour market conditions are improving. The unemployment rate has fallen further, to close to the pre-crisis level. Employment has continued to grow, more recently also in terms of average hours worked, and labour force participation has increased in a number of countries, pointing to sustainable improvements in labour supply. Nominal wage growth, mainly reflecting annual growth of negotiated wages, has been strengthening for several quarters, in line with improving labour markets. Nonetheless, there have not yet been signs of strong real wage growth. Headline inflation has temporarily increased to above the ECB objective, but core inflation remains stuck around 1% in annual terms. A gradual build-up in domestic cost pressures from continuing wage growth and dissipating slack will be necessary for a sustainable increase in core inflation.

Resilient and more inclusive growth requires further institutional and structural reforms

In September, the ECB reiterated the timeline for withdrawing its asset purchase programme, which is appropriate given that deflation risks have receded and monetary policy will have to gradually shift to a less accommodative stance as the recovery continues. As inflation is set to progressively return to the objective of below, but close to 2%, the ECB is projected to gradually tighten its policy stance, in line with the guidance that the rates will remain unchanged at least through the summer of 2019. A cautious and gradual reduction of support is warranted in an environment of continuing weakness in core inflation, and to avoid potential disruptions in financial markets. It is assumed that the deposit rate will return to positive levels, reaching 0.2% at the end of the projection period, while the main refinancing rate will reach 0.4%, an increase of, respectively, 60 and 40 basis points between now and end-2020.

In the euro area as a whole, the fiscal stance is expected to be slightly expansionary in 2019 but become neutral in 2020. Public debt-to-GDP ratios remain above historical averages in many countries. As the recovery continues, governments should ensure that debt-to-GDP ratios fall significantly by improving fiscal positions and by introducing structural reforms to strengthen growth. The credibility and effectiveness of the EU fiscal governance should also be strengthened by simplifying fiscal rules. Progress in completion of the banking union, in particular by creating a common fiscal backstop to the Single Resolution Fund and reaching an agreement on the European Deposit Insurance Scheme, remains key to enhancing the resilience of the euro area to a future downturn and financial stability risks. The creation of a common fiscal capacity would also buttress the capacity of the euro area to withstand negative shocks.

Sustained improvements in living standards are held back by weak productivity growth and investment in many countries. Deepening the Single Market requires further product market reforms to boost competition, in particular in the services sector, and to enhance diffusion of new technologies. Swift completion of the single market in network sectors and services would also foster productivity growth and unlock further investment, particularly in trans-European transport and energy networks.

Growth will gradually moderate

GDP growth is projected to ease from 1.9% in 2018 to 1.6% in 2020, supported by strongly accommodative monetary policy, improving job creation and slight fiscal support. Private consumption growth will benefit from rising employment and more wage growth. The recovery in business investment is expected to continue, supported by favourable financing conditions and the need to expand production capacity. Inflation is projected to strengthen gradually in an environment characterised by disappearing slack and higher wage growth.

Policy uncertainty is high and could increase further. An escalation of trade tensions could further undermine trade and investment. Brexit is not a major macroeconomic risk for the euro area as a whole, but countries with the closest trade links to the United Kingdom could be severely impacted if the United Kingdom left the European Union without a negotiated agreement. High-debt countries may have difficulties coping with higher borrowing costs and possible contagion effects in the event of renewed stress in sovereign bond markets or a faster-than-expected withdrawal of monetary policy support. On the upside, a faster labour market recovery and resulting wage growth or stronger confidence generated by an agreement on major euro area institutional reforms could lead to stronger-than-expected growth.