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European Economic Forecast

Winter 2018 (Interim)

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EUROPEAN ECONOMY



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European Commission
Directorate-General for Economic and Financial Affairs

European Economic Forecast

Winter 2018 (Interim)

EUROPEAN ECONOMY

Institutional Paper 073

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A SOLID AND LASTING EXPANSION

Economic activity in the euro area turned out stronger than expected in the second half of 2017, with GDP growing by 0.7% and 0.6% q-o-q in the third and last quarters of the year. Survey data also suggest that growth momentum should remain robust in early 2018.

While the broad-based acceleration of global economic activity and trade over the course of last year benefitted the euro area, domestic demand also strengthened, enhanced by above-average business and consumer sentiment, continued policy support, and improving labour markets.

The European economy therefore looks set to continue expanding at a solid pace. Robust job creation is expected to continue providing fuel for consumer spending growth. At the same time, investment conditions are set to remain favourable with both domestic and foreign demand expected to strengthen and financing conditions expected to remain loose. The remaining slack in the economy should allow for GDP to continue growing at rates that are higher than the estimated rate of potential growth (around 1½%) throughout the forecast horizon. The cyclical momentum in the euro area, however, is forecast to moderate slightly over the course of 2018 as the brisk pace of employment growth starts to ease. Euro area and EU GDP is estimated to have grown by 2.4% in 2017 and is forecast to expand by 2.3% in 2018 before easing somewhat to 2.0% in 2019.

While labour market conditions have improved across all Member States, unemployment rates continue to vary significantly. Nevertheless, the forecast for GDP growth has been revised up for a large majority of euro area Member States in each of the years covered by the forecast and growth rates are expected to converge further.

Due to remaining slack in the labour market, wage pressures and core inflation are expected to rise only gradually. Temporary factors related to energy prices will therefore continue to play a major role in inflation developments and will maintain the headline HICP inflation rate above core inflation over much of 2018. After 1.5% in 2017, HICP inflation is forecast to average 1.5% over 2018 before edging-up to 1.6% in 2019.

Risks to the outlook for GDP and inflation remain broadly balanced. While there appears to be room for growth to exceed expectations in the coming quarters, this could lead to growth-limiting supply-side constraints kicking in earlier than otherwise expected. At the same time, benign market expectations concerning asset price valuations appear vulnerable to a re-assessment of sentiment and fundamentals. Risks related to the outcome of Brexit negotiations remain, as do downside risks associated with geopolitical tensions and a shift towards more inward looking and protectionist policies.

Table 1:

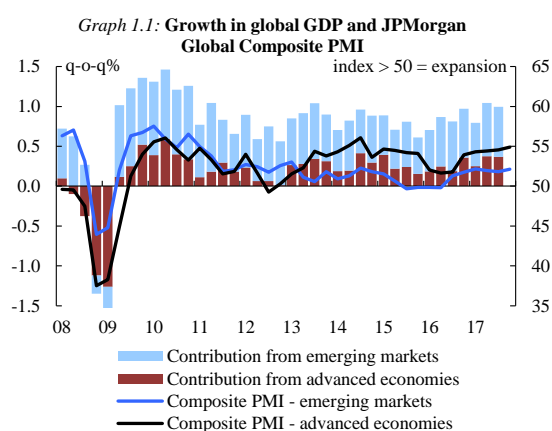
Overview - the winter 2018 (interim) forecast

	Real GDP						Inflation					
	Winter 2018 forecast			Autumn 2017 forecast			Winter 2018 forecast			Autumn 2017 forecast		
	2017	2018	2019	2017	2018	2019	2017	2018	2019	2017	2018	2019
Euro area	2.4	2.3	2.0	2.2	2.1	1.9	1.5	1.5	1.6	1.5	1.4	1.6
EU27	2.6	2.5	2.1	2.4	2.2	2.0	1.6	1.7	1.7	1.6	1.5	1.8
EU28	2.4	2.3	2.0	2.3	2.1	1.9	1.7	1.9	1.8	1.7	1.7	1.8

1. EA AND EU OUTLOOK

1.1. GLOBAL ECONOMY CONTINUES TO FIRM

Momentum in the global economy remains strong, as the broad-based cyclical upswing continues, buoyed by the rebound in investment and trade, still favourable financial conditions and a supportive policy mix. Higher commodity prices are also proving supportive for commodity exporters. The near-term outlook is slightly stronger than projected in autumn, with global GDP growth outside the EU now expected at 4.1% in both 2018 and 2019, compared to 3.8% in 2017. Upward revisions since the autumn are mostly concentrated in advanced economies, particularly the US, but growth prospects have also improved for some emerging markets, including China. Sustained, robust momentum in the near term is consistent with the broad-based strength in business and household confidence across most emerging markets and advanced economies (see Graph 1.1).

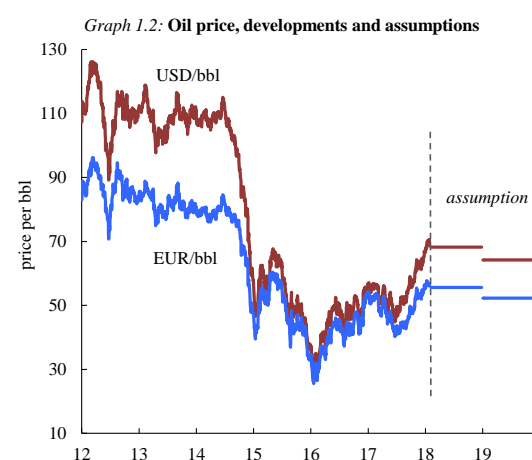


Sources: Macrobond, IMF and national statistical institutes for GDP, JPMorgan/Markit for PMI.

In the US, economic activity remains buoyant, supported by a number of benign factors, namely easy financial conditions, a weaker dollar, expansion in the energy sector, and strong external demand. The recent US tax reform is expected to add to this momentum, generating a fiscal stimulus of around 1½ pps. of GDP over 2018-2019, and boosting economic growth further in the near term due to higher business investment, as well as household spending. However, given the advanced stage of the cycle, some of the stimulus may be offset by faster monetary policy normalisation and higher interest rates than assumed earlier. Given the temporary nature and heavy frontloading of

some tax reform elements and the current above-potential growth, US growth might turn lower in the longer term.⁽¹⁾ As regards emerging markets, the near-term growth outlook has also improved slightly, including in commodity exporters and China, where export growth is buoyant and service sector momentum has strengthened.

Global import volumes (outside the EU) are expected to have grown by 4.6% (y-o-y) in 2017 (compared to 1.3% in 2016), driven by solid imports in advanced economies, and buoyant trade across Asia and most other emerging market economies. The momentum is expected to carry into 2018 and to moderate only slightly in 2019. Global import growth is expected to pick up by 4.7% in 2018 and 4.5% in 2019 (up from 4.1% for both years in the autumn forecast). This reflects an upward revision to the outlook for global GDP growth and a further uptick in the elasticity of trade, largely driven by stronger investment dynamics.



The extension of an agreement on production cuts between OPEC and Russia, as well as geopolitical tensions in the Middle East, lifted Brent oil prices to nearly 70 USD/bbl in January, considerably higher than assumed in the autumn forecast. Further price rises, however, are projected to be more limited as higher oil prices would weigh on global demand growth and non-OPEC producers (notably the US⁽²⁾) are expected to increase output. Based on futures markets, prices for Brent oil are assumed to increase by an average of 24.6%

⁽¹⁾ IMF (2018). World Economic Outlook Update, January.

⁽²⁾ See ECB (2017). 'The oil market in the age of shale oil'. *Economic Bulletin* 8, pp. 57–74.

to 68.3 USD/bbl in 2018 compared to 2017, before falling by 5.9% to 64.2 USD/bbl in 2019 (see Graph 1.2).

1.2. FINANCIAL CONDITIONS REMAIN SUPPORTIVE

Monetary policy divergence has increased...

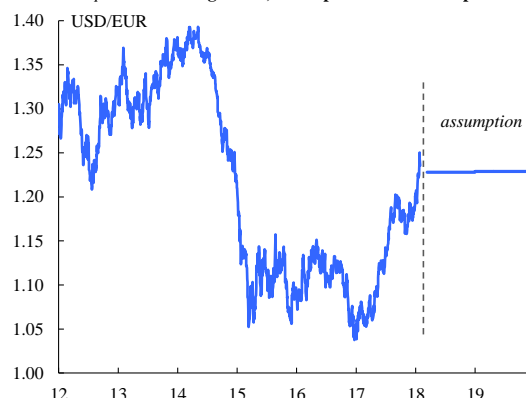
Since autumn, monetary policy divergence across advanced economies has widened. At its recent meetings, the ECB Governing Council decided to keep unchanged its forward guidance on policy rates. It also decided to recalibrate its asset purchase programme (APP), extending the expected duration of purchases to at least September 2018 and reducing the size of its monthly purchases to EUR 30bn from January 2018 onwards. In January 2018, the Governing Council confirmed that an ample degree of monetary stimulus remained necessary. In December, the Bank of Japan re-affirmed its strong commitment to its inflation target and decided to maintain its highly accommodative monetary policy stance.

By contrast, the US Federal Reserve (Fed) in December raised its target range for the federal fund rate for the third time in a year, to 1.25-1.50%. At their monetary policy meeting, US policymakers expected that three additional interest rate hikes would be warranted in 2018, signalling a somewhat faster pace of normalisation than expected by markets. As widely anticipated, the Bank of England raised rates for the first time in 10 years, delivering a 25bps. hike to 0.5%. Looking ahead, the Bank signalled that any future increases in the policy rate would likely be gradual and limited.

...and the euro exchange rate strengthened.

The euro has appreciated more than 2% in nominal effective terms since November 2017, driven by stronger-than-expected economic growth, lower political uncertainty, and expectations of a faster pace of monetary policy normalisation. At the same time, the euro has appreciated by about 7% against the US dollar (see Graph 1.3).

Graph 1.3: Exchange rates, developments and assumptions

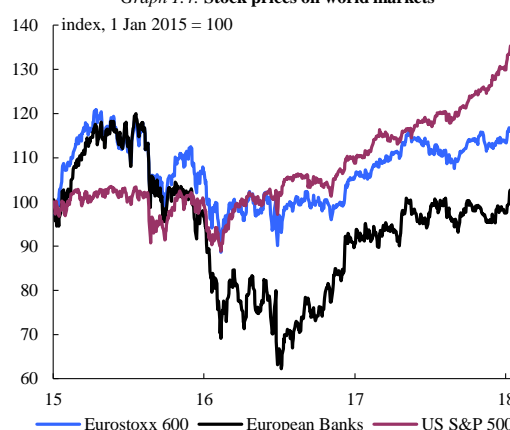


Bond and equity markets are buoyant...

In the sovereign bond markets, benchmark yields in the EU have picked up since the turn of the year but remain very low. Most sovereign bond spreads have continued to narrow as the economic and fiscal outlook has strengthened. In the US, 10-year Treasury yields have moved up. In the EU, real yields, at least of the highest rated sovereigns, remain negative across the maturity spectrum.

European equity indices further strengthened but have underperformed global peers, as the appreciation of the euro has clouded the corporate earnings outlook (see Graph 1.4). US stock indices have recently dropped from the record highs they had reached on the back of the government's tax package and strong corporate earnings.

Graph 1.4: Stock prices on world markets



With the economic expansion broadening and interest rates persistently low, global investors remain in a search-for-yield mode. As a result, the compensation for inflation and credit risks has been squeezed. Consistent messaging from the Fed and the ECB that the normalisation of monetary

policy would be prudent, gradual and well communicated in advance has reassured risk-on investors.

Based on the most reliable valuation measures, US stocks seem pricy.⁽³⁾ While the low interest rate environment should *per se* favour high equity valuations, valuations have to be seen in the context of lower growth prospects in the medium term as the cycle matures and the impact of population ageing becomes stronger. At the same time, profit margins are unlikely to indefinitely remain as high as they are now. European stock markets, by contrast, appear more moderately valued.

...and lending conditions improved further.

Bank lending in the euro area has continued to expand. Last year, loans to households grew by 2.8% and loans to non-financial corporations by 2.9%. The January 2018 ECB Bank Lending Survey also provides positive signals consistent with the ongoing recovery in bank lending volumes, with competitive pressures and risk perceptions having an easing impact on credit standards. Looking towards 2018-Q1, banks expect a net easing of credit standards and increased net demand across all loan segments.

Market funding continued to expand in the euro area with positive monthly net issuance of both equity and corporate bonds. Despite strong corporate bond issuance volumes (+9.6% annual growth rate in November 2017), bank lending contributed slightly more than bonds to the overall funding of non-financial corporations (NFCs) over the last couple of months. This is unsurprising in the current stage of the economic cycle, even though NFCs seem to have generally adopted more market-oriented funding structures.

Overall, both households and NFCs are expected to continue benefitting from supportive financing conditions over the forecast horizon. Furthermore, the euro area corporate sector continues to generate sizeable internal funds, which could potentially be used to support investment spending.

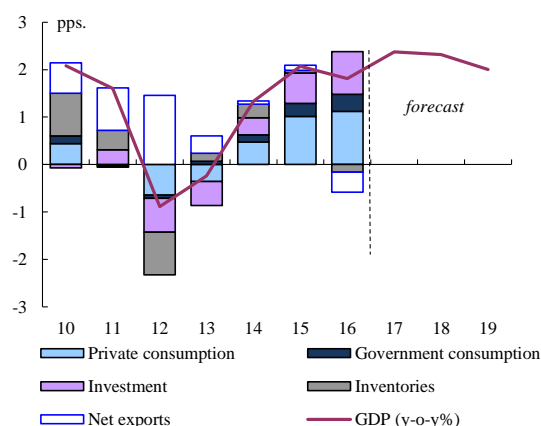
⁽³⁾ Shiller cyclically-adjusted price-to-earnings ratio (P/E), Market Capitalisation/Gross Value Added ratio, Market Capitalisation/GDP and Tobin's Q.

1.3. EXPANSION MAKING HEADWAY

Growth remained robust...

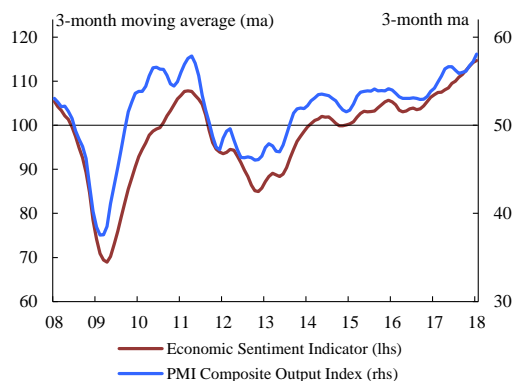
In 2017-Q3, GDP grew by 0.7% (q-o-q) in both the euro area and the EU, the same as in the previous quarter and slightly above earlier expectations. The y-o-y rate stood at its highest since 2011-Q1. According to Eurostat's preliminary flash estimate, the European economy ended 2017 on a strong note, growing by 0.6% (q-o-q) in the last quarter. The EU and euro area economies have now been growing by at least 0.6% for five consecutive quarters.

Graph 1.5: Real GDP and its components, euro area



For the year as a whole, GDP is estimated to have grown by 2.4% in both the euro area and the EU, higher than predicted in the autumn and the highest rate in 10 years. The upward revision reflects stronger-than-expected growth in the second half of the year, well above potential (see Graph 1.5).

Graph 1.6: Economic Sentiment Indicator and PMI Composite Output, euro area



Source: EC, Markit Group Limited

The robust and broad-based nature of the expansion, across sectors and countries, benefited

from high consumer and business confidence, an improving labour market, continued policy support, and stronger global output and trade (see Graph 1.6).

...and the expansion is increasingly broad-based...

Domestic demand remained the main growth engine over the first three quarters of 2017⁽⁴⁾ although net trade made the largest contribution in the third quarter (+0.5 pps. in the euro area). This development may be less significant than it seems, however, because domestic demand remains the main driver when highly volatile Irish data is excluded. Gross fixed capital formation in Ireland dropped by 36% (q-o-q) in 2017-Q3, which led to a contraction of euro area investment of 0.3% (q-o-q). Excluding Ireland, investment dynamics in the euro area would have remained strong, growing at a rate of at least 1% (q-o-q) for the third consecutive quarter. The annual growth rate of investment in the euro area, excluding Ireland, is estimated to have reached 4.5%, its highest since 2007-Q3.

Private consumption expenditure continued to benefit from the improved performance of the labour market, although it lost some momentum in the third quarter when growth slipped to 0.4% (q-o-q) compared to 0.6% in the preceding quarter. Expenditure on non-durable goods and services moderated appreciably whereas household consumption of durable goods picked up compared to the previous quarter. At the same time, government consumption growth remained stable in the euro area at 0.3%, staying in the range of 0.2% \pm 0.1 pps. for the sixth consecutive quarter.

Despite a stronger euro, euro area exports rose by 1.5% q-o-q in 2017-Q3 (after +1.1% in 2017-Q2), in line with the higher momentum in world trade. Importantly, it was also the highest annual rate since the first half of 2015. Imports increased by 0.5% (after +1.6% in 2017-Q2), also reflecting a sharp contraction of Irish imports (-10.9% q-o-q).

...with continued cyclical momentum ahead...

Signals from recent surveys are consistent with continued strong growth in the near term. The European Commission's Economic Sentiment Indicator (ESI) rose considerably in the fourth quarter of 2017, reaching its highest levels since

2000 in the euro area and the EU in October and August respectively. In January 2018, the ESI weakened slightly in the euro area and the EU for the first time in eight months. This softening was driven by lower confidence in services and retail trade. Despite this slight decline, the ESI remains above its 2017-Q4 average, its highest in 17 years. In parallel, the euro area Flash Composite Output Purchasing Managers' Index (PMI) increased in January to its highest reading in nearly 12 years, mostly on the back of the fastest acceleration of service sector growth since August 2007.

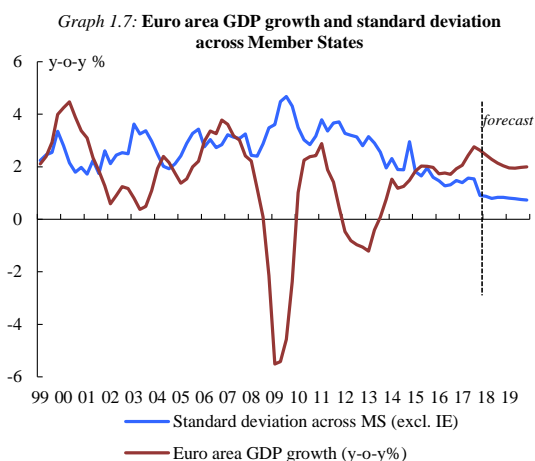
...on the back of increasingly solid fundamentals...

The growth outlook for 2018 has been revised upwards compared to the autumn forecast. Diminishing uncertainty, improving sentiment and the synchronous rebound outside Europe led to a stronger-than-expected expansion in the second half of last year. With a stronger carry-over from 2017 and continued growth momentum in early 2018, GDP is now expected to grow by 2.3% this year in both the euro area and the EU. While growth is still forecast to moderate gradually, this now looks likely to set in later than previously expected.

Over the forecast horizon, the expansion is set to remain solid, broad-based across sectors and countries, and increasingly self-sustained. As in autumn, it is expected to continue benefiting from a supportive policy mix, with monetary policy remaining overall accommodative, and a broadly neutral fiscal policy stance in the euro area as whole. Although the output gap is set to become positive, the remaining slack in the labour market offers scope for solid growth to continue. Moreover, all euro area countries are set to grow in the forecast years, with growth differentials narrowing further (see Graph 1.7).

Domestic demand is set to remain the main growth engine in 2018, with private consumption continuing to grow at a robust pace and investment continuing to recover. Exports are also expected to support the expansion going forward, on the back of strong external demand. With job creation expected to ease from its current brisk pace, the resulting slowdown in household purchasing power growth implies a slight moderation in momentum towards 2019.

⁽⁴⁾ GDP components are not yet available for 2017-Q4.



Given the ongoing negotiations over the terms of the UK's withdrawal from the EU, projections for 2019 are based on a purely technical assumption of status quo in terms of trading relations between the EU27 and the UK. As in the autumn, this is for forecasting purposes only and has no bearing on the outcome of the talks underway in the context of the Article 50 process.

...with domestic demand to remain robust...

Private consumption should continue benefitting from high consumer confidence and labour market improvements this year and next, though at a slower pace. Lower deleveraging needs, as well as past increases in house prices could further support the near-term outlook.

Investment should continue to grow at a robust pace this year and next. According to the European Commission's latest investment survey, investment volumes in the euro area manufacturing sector are expected to accelerate this year compared to 2017. Overall respondents report the best investment climate in 10 years. The pick-up in investment intentions is also underpinned by the continuing rise in capacity utilisation, which is now well above its long-term average and at its highest since 2008-Q2.

Favourable financing conditions, diminished uncertainty, strong sentiment, and increasing corporate profitability are all set to support business investment. The improved external demand outlook should further translate into a stronger impetus for equipment investment. As in the autumn, assuming that the overall monetary stance remains accommodative, market expectations of a steepening yield curve should only have a limited negative impact on investment.

Furthermore, the Investment Plan for Europe is expected to boost investment through improved access to finance. ⁽⁵⁾

...and exports benefiting from the strong momentum in world trade.

The strengthening external environment creates scope for European exports to perform even better than expected in the autumn. This is consistent with surveys showing an improvement in export order book expectations over the last three months. Despite the euro's appreciation, ⁽⁶⁾ euro area export growth is expected to remain robust with imports following their historical elasticity to final demand.

Overall, euro area GDP is forecast to continue growing in 2018 at broadly the same pace as in 2017 (2.3%), before moderating to 2.0% in 2019. The expected gradual withdrawal of policy stimulus, the uncertainty around the Brexit transition agreement and the emergence of supply-side constraints are set to weigh on economic activity. The expected slowing of economic growth in 2019 is also consistent with a gradual convergence of actual growth towards potential growth in the medium term.

1.4. LABOUR MARKET CONDITIONS CONTINUE TO SHOW STRONG DYNAMICS

In the first three quarters of 2017, the euro area's labour market improved further amid a solid economic expansion. Employment rose by 0.4% quarter-on-quarter in 2017-Q3, resulting in an annual increase of 1.6%. The number of employed persons currently stands at the highest level ever recorded. Yet the number of total hours worked in the economy remains below its pre-crisis level (by 3%) despite continuing to rise in line with job creation. This reflects the change in the composition of employment towards a higher share of part-time employment but also suggests that labour resources remain underutilised. Involuntary

⁽⁵⁾ As of December 2017, operations approved under the Investment Plan for Europe, were expected to trigger 256.1 billion in investments. Around 539,600 small and medium-sized companies (SMEs) are expected to benefit from improved access to finance.

⁽⁶⁾ On the impact of an appreciation of the euro exchange rate see *European Economic Forecast – Autumn 2015*, European Economy Institutional Paper 63/2017, Section I.1, pp. 38–39).

part-time work - though diminishing - remains high. ⁽⁷⁾

In November 2017, the unemployment rate in the euro area stood at 8.7%, its lowest level since January 2009. The fall in unemployment has continued to be stronger than suggested by the pace of economic expansion. ⁽⁸⁾ Labour market conditions have improved across all Member States. Though significant differences remain, such improvements are reflected in a lower dispersion of unemployment rates. Although it continues to fall, long-term unemployment remains above its pre-crisis level.

Survey indicators of firm's employment expectations are consistent with continued job creation in the fourth quarter of last year and in the period ahead, with the unemployment rate set to continue falling. In January, hiring intentions in the manufacturing sector stood close to a 30-year high and are at their highest since early 2001 in the services sector (see Graph 1.8). At the same time, there are growing signs of labour shortages in some Member States and sectors, implying that employment growth is set to moderate over the forecast horizon. Both in the industry and services sectors, the percentage of firms mentioning labour as a factor limiting production has been increasing, particularly over the past two years.



⁽⁷⁾ Coeuré, B. (2017). 'Scars or scratches? Hysteresis in the euro area'. Speech at the International Center for Monetary and Banking Studies, Geneva, 19 May.

⁽⁸⁾ See, European Commission (DG Employment, Social Affairs and Inclusion) (2017). 'Labour Market and Wage Developments in Europe, Annual Review'.

1.5. THE OUTLOOK FOR INFLATION REMAINS SUBDUED

Despite the impact of higher energy prices, euro area inflation remained subdued in the fourth quarter of 2017, with headline inflation softening to 1.4% in December from 1.5% in November. Average inflation in the fourth quarter stood at 1.4%, marginally below what was expected in the autumn. This could be attributed to special factors within services inflation related to transport, packaged holidays and accommodation components which declined strongly. At the same time, non-energy industrial goods inflation remained broadly flat, whereas food price inflation increased notably in the last quarter of the year. The impact of energy inflation was positive given the increase in oil prices, although this was partly offset by base effects. ⁽⁹⁾

Mostly as a result of slowing services inflation, core inflation – which excludes volatile energy and unprocessed food prices – remained subdued at 1.1% throughout the fourth quarter, down from 1.3% in the preceding quarter. That core inflation remains subdued mostly reflects the lagged negative impact of a prolonged period of low inflation dragged by the past collapse in oil prices, and weak wage dynamics related to, among other things, ⁽¹⁰⁾ labour market slack.

Indeed, considering the sustained improvement in the labour market, wage growth has remained unusually contained. The annual growth of both nominal compensation per employee and negotiated wages stood stable in 2017-Q3 compared to the preceding quarter (at +1.7% and +1.5%, respectively), whereas hourly labour cost growth slipped to +1.6% (+1.8% in 2017-Q2). Overall, annual unit labour cost growth remained muted in the third quarter of the year, reflecting a cyclical improvement in productivity and moderate growth in compensation per employee.

All these factors are set to change course as the synchronised upswings in economic activity and oil prices are expected to exert a positive impact in both 2018 and 2019. Their effect, however, is

⁽⁹⁾ Base effects are defined as the contribution to the change in the year-on-year inflation rate in a particular month that stem from a deviation of the non-seasonally adjusted month-on-month rate of change in the same month of the preceding year from the usual seasonal pattern.

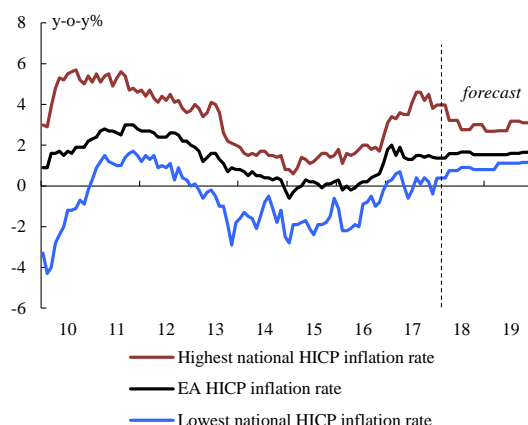
⁽¹⁰⁾ See M. Ciccarelli and C. Osbat (2017), eds. 'Low inflation in the euro area: Causes and consequences'. *ECB Occasional Paper Series* 181.

expected to be muted somewhat by the euro's higher effective exchange rate. According to the Commission's surveys, industry managers' selling-price expectations reached their highest level since mid-2011, while service managers' expectations are well above their historical average and have been on an upward trend since early 2013. Although still below the long-term average, consumers' price expectations are now close to their highest level since early 2014. Furthermore, industrial price pressures at the producer level also crept up during the year.

Over the forecast horizon, headline inflation is expected to rise modestly although with a humped-shaped profile in 2018, mainly driven by the pass-through of oil price movements⁽¹¹⁾. Inflation differentials are also expected to narrow, with the lowest inflation rates forecast to converge gradually towards the euro area average, whereas the highest inflation rates - mainly in the Baltic States - reflect the robust economic growth of the respective countries and also move towards the euro area average rate (see Graph 1.9). Overall, headline inflation is forecast to average 1.5% over 2018, slightly higher than forecast in the autumn. Positive energy base effects are set to kick in materially in the second and third quarters of the current year. The implementation of a number of tax measures may further impact the shape of inflation developments. These include the increase in tobacco and fuel taxes in France in 2018 and higher indirect taxes in the Netherlands in 2019.

In 2019, with above-trend growth, the diminishing slack in the labour market is projected to lift domestic price pressures and to eventually reassert labour market-wage-inflation linkages.⁽¹²⁾ This should result in a gradual up-tick in core and headline inflation in the euro area despite the downward slope of the oil price futures curve (as of the cut-off date). Headline inflation is thus expected to stand at 1.6% in 2019, unchanged compared to the autumn forecast.

Graph 1.9: Inflation dispersion, euro area Member States



Market-based measures of inflation expectations⁽¹³⁾ have continued to recover and have risen gradually since autumn. At the cut-off date of this forecast, inflation-linked swap rates at the one-year forward one-year-ahead horizon stood at around 1.3%. Swap rates at the three-year forward three-year-ahead horizon imply an average inflation of close to 1.6%. On a longer horizon, the widely watched five-year forward five-year-ahead indicator suggests inflation of 1.8% (see Graph 1.10). Moreover, the ECB's January 2018 Survey of Professional Forecasters includes inflation forecast means of 1.5% in 2018 and 1.7% in 2019 (up from 1.4% and 1.6% respectively in the 2017-Q4 exercise). Longer-term inflation expectations stood unchanged at 1.9%.

Graph 1.10: Inflation expectations derived from implied forward inflation-linked swap rates



Source: Bloomberg

⁽¹¹⁾ ECB (2016). 'Oil prices and euro area consumer energy prices'. *Economic Bulletin* 2, pp. 9–11. Holm-Hadulla, F. and K. Hubrich (2017). 'Macroeconomic implications of oil price fluctuations: a regime-switching framework for the euro area'. *ECB Working Paper Series* 2119.

⁽¹²⁾ Mersch, Y. (2017). 'Challenges for euro area monetary policy in early 2018'. Speech at the 32nd International ZinsFORUM. Frankfurt am Main, 6 December.

⁽¹³⁾ Market-based inflation expectations such as inflation swap-rates are influenced by inflation risk and liquidity premiums, so the measured rate does not necessarily reflect underlying inflation expectations directly.

1.6. RISKS REMAIN BROADLY BALANCED

Overall, risks to the growth outlook remain broadly balanced. The risk factors in the short term and the medium term, however, are quite different.

On the upside, there is scope for growth to gather further momentum in 2018, triggered by positive feedback loops emerging from economic sentiment, investment and wage dynamics. However, should this happen, the expansion could run into supply-side constraints sooner than otherwise expected. In addition, clear progress on deepening the EMU could boost confidence and growth during the forecast years making the euro area more resilient in the face of possible asymmetric shocks.

Downside risks have also become more pronounced. The latter are mostly found on the

external side such as the possibility of tighter global financial conditions as well as the potential of a sharp correction in financial markets. Such an event could be triggered by, for example, a faster-than-expected tightening of US monetary policy (caused by e.g. stimulus-driven inflation surprises). Stretched valuations for some asset classes, including equity, combined with broadly-based low volatility and compressed risk premia suggest that global financial markets may be vulnerable to a re-assessment of fundamentals and risks.⁽¹⁴⁾ This could expose fragilities related to the debt overhang in a number of Member States. Also risks related to the outcome of Brexit negotiations remain, as do risks associated with a shift towards more inward looking and protectionist policies. The relevance of downside risks related to geopolitical tensions in the Middle East and the Korean peninsula appears to have increased.

⁽¹⁴⁾ See also, 'A paradoxical tightening', *BIS Quarterly Review*, December 2017; and, 'Higher future financial market volatility: potential triggers and amplifiers', *ECB Financial Stability Review*, November 2017.

2. PROSPECTS BY MEMBER STATES

2.1. BELGIUM: GROWTH GAINING MOMENTUM

Belgium's economy grew an estimated 1.7% in 2017, up from 1.5% for 2016, driven mainly by domestic demand, particularly private consumption and, to a lesser extent, investment.

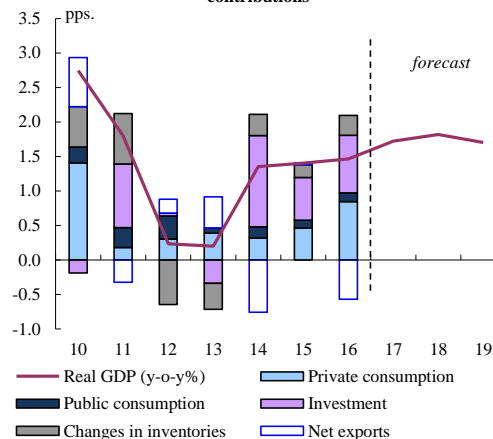
The latest soft and hard indicators remain above their long-term averages, highlighting the strongest levels of consumer and business confidence since the early 2000's. Overall, economic growth is expected to strengthen to 1.8% in 2018 as an improving labour market fuels private demand growth and investment conditions strengthen. GDP growth is expected to ease slightly to 1.7% in 2019 due to a gradual weakening of investment growth. The contribution of public consumption is set to remain relatively muted, as Belgium is projected to keep a tight rein on public expenditure growth.

The contribution of private investment to growth is expected to increase in 2018. Household investment is projected to remain relatively stable as interest rates are expected to rise moderately. Non-financial corporations, by contrast, are expected to raise their already high level of investment, amid very favourable financing conditions, sizeable liquidity reserves and elevated capacity utilisation rates. Growth in public investment in 2018 is expected to be driven by large infrastructure works, defence expenditure and the local investment cycle. Investment growth is expected to slow down slightly in 2019.

Net exports made a slightly positive contribution to growth in 2017 but are expected to have a broadly neutral impact over the forecast horizon. Stronger domestic demand will raise imports, while exports should enjoy support from dynamic demand in Belgium's main trading partners.

Headline inflation rose to 2.2% in 2017, up from 1.8% in 2016, mainly due to higher energy prices. The phasing-out of a tax on electricity consumption in Flanders and the abrogation of a television license fee in Wallonia are expected to contribute to lower headline inflation, which is projected to decline to 1.5% in 2018 before edging up to 1.6% in 2019. The inflation gap between Belgium and the euro area narrowed to 0.7 pps. in 2017 and is expected to close in 2018.

Graph 2.1: Belgium - Real GDP growth and contributions



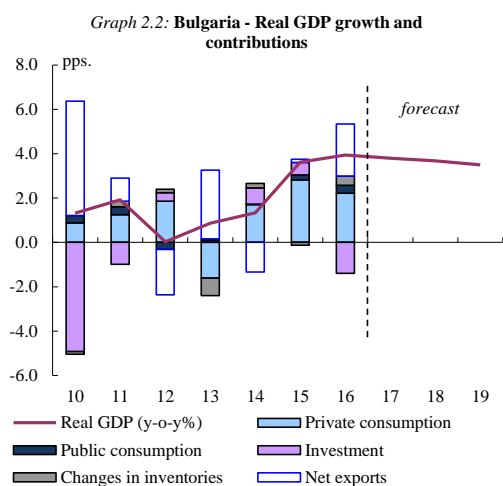
2.2. BULGARIA: GDP GROWS BACKED BY STRONG DOMESTIC DEMAND

Bulgaria's economic growth remains strong. Real GDP growth in 2017 is estimated at 3.8%, driven by both consumption and investment. Higher consumption was fuelled mostly by strong wage increases linked to tighter labour market conditions and to public sector wage increases. Investment recovered, especially in the public sector, as the implementation of EU-backed investment programmes supported government capital expenditure. Net exports' contribution to GDP growth turned negative, as imports grew faster in response to higher domestic demand and export growth slowed down, following a very strong performance in 2016.

GDP growth is forecast to remain robust at 3.7% in 2018 and 3.5% in 2019. The main engine of growth will continue to be strong domestic demand, while the external sector's contribution is expected to turn positive only in 2019. EU funds are set to further boost public investment in 2018, while increases in wages should continue to stimulate private consumption. Both investment and private consumption are expected to remain the main drivers of growth in 2019.

Inflation, which has been negative for three years, turned positive and reached 1.2% in 2017, mainly as a result of higher energy and commodity prices, as well as higher administrative prices for utilities. Over the forecast period, inflation is projected to gradually increase, rising to 1.4% in 2018 and 1.5% in 2019. This is mainly due to the global oil

prices, which are assumed to continue pushing upwards energy prices, but at a declining rate. At the same time, core inflation is expected to rise as the growth in household disposable incomes, fuelled by positive labour market developments, boosts private demand.



2.3. CZECH REPUBLIC: STRONG GROWTH AND TIGHTENING LABOUR MARKET

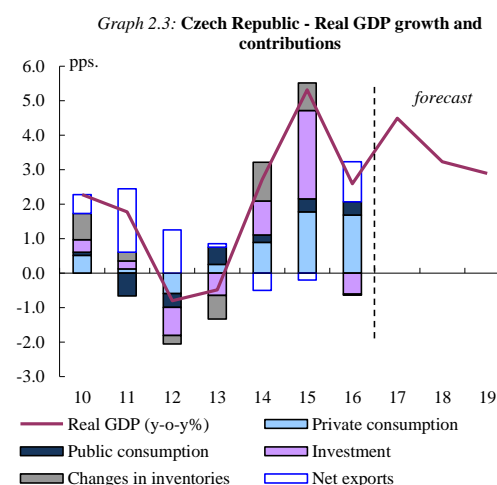
The Czech Republic is experiencing an economic upswing. Real GDP growth in 2017 likely exceeded potential growth by a significant margin, driven by private consumption and investment and in spite of a tightening labour market. Although growth is expected to moderate in 2018 and 2019, inflationary pressures will continue as a result of the positive output gap.

The Czech Republic's economy is forecast to have grown by 4.5% in 2017, considerably higher than in 2016, when the economy expanded by 2.6%. After surging in the first half of 2017, GDP growth likely moderated in the second half with estimated growth of 0.7% (q-o-q) in the last quarter of 2017, following 0.5% in the third quarter. Labour market constraints are rapidly pushing wages up, which in turn is feeding into household consumption. At the same time, investment has started to again contribute strongly to growth, with increasing support of EU funds.

GDP growth is expected to moderate in 2018 and 2019 but to remain strong at 3.2% and 2.9%, respectively, underpinned by domestic demand. While exports are expected to continue growing solidly thanks to robust global demand, their

positive effect on GDP growth will tend to be neutralised by strong import growth.

HICP inflation accelerated to 2.4% in 2017, from 0.6% in 2016, largely due to higher food and services prices. The central bank's decision to remove its exchange rate peg in April 2017 and its subsequent interest rate hikes seem to have tempered inflationary pressures on imported goods and services. Headline inflation is expected to remain unchanged at 2.4% in 2018 and to stabilise at 2.0% in 2019. The main contributions in 2018 are once again expected to come from food and services, while energy prices are assumed to rise significantly in the first half of the year. Overall, annual core inflation is expected to decrease slightly in 2018 and 2019.



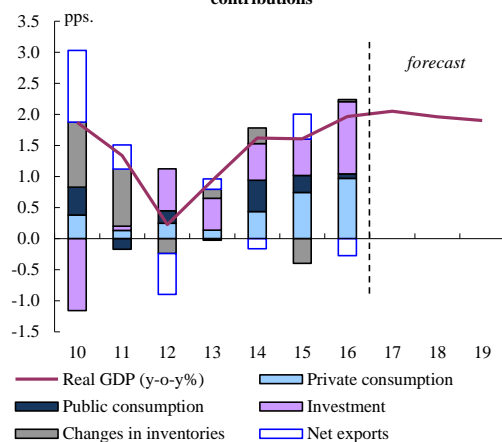
2.4. DENMARK: STEADY GROWTH MOMENTUM

Despite a sharp setback in the third quarter of 2017, Denmark's economy is enjoying a solid upswing. Real GDP growth is estimated to have reached 2.1% in 2017, driven by net exports, private consumption and investment. However, despite steady employment and disposable income growth, private consumption turned out weaker than previously expected in 2017, partly because car sales plummeted in the third quarter in anticipation of an announced reduction in car taxes that took effect in the fourth quarter.

Economic growth is forecast to remain solid, with real GDP growth of 2.0% in 2018 and 1.9% in 2019. The upswing is set to remain broad-based with more dynamic private consumption helping to sustain GDP growth.

Private consumption is expected to gain additional support from policy measures which Danish authorities estimate would boost households' disposable income by 0.2% of GDP in 2018 and 0.6% of GDP in 2019. The export and investment outlook remain positive as GDP growth is forecast to show continued momentum in Denmark's main export markets. Supported by rising house prices, residential investment is forecast to remain an important driver of investment growth over the forecast horizon.

Graph 2.4: Denmark - Real GDP growth and contributions



Price pressures have been subdued since 2013 with HICP growing at an annual average of just 0.3%. However, inflation started to strengthen in 2017, reaching 1.1% amid relatively strong increases in food and services prices. This trend looks set to continue and rising energy prices are projected to further lift the annual rate of inflation. As a result, HICP inflation is forecast to gradually increase to 1.4% in 2018 and 1.6% in 2019.

2.5. GERMANY: ROBUST GROWTH AHEAD

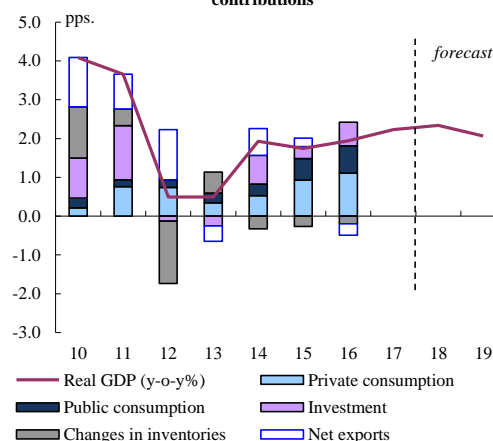
Germany's GDP growth reached a six-year high of 2.2% in 2017, driven by strong private consumption, higher investment and growing foreign demand. Economic sentiment continues to improve across sectors, suggesting continued expansion in the coming quarters. Survey data show expectations of improving orders, higher output and greater demand.

Equipment investment has overcome the soft patch it experienced in 2016 and is likely to strengthen further over the course of 2018 amid favourable demand prospects, not least from the euro area and the rest of the EU. The steady rise in capacity

utilisation rates should also spur renewal and expansion of the capital stock. The strong growth in housing investment recorded in the first two quarters of 2017 is expected to moderate somewhat but continue, according to data on residential construction permits.

Private consumption growth fuelled by the strong labour market, favourable world trade developments and economic growth in the rest of the euro area should continue to sustain the upswing. Overall, real GDP growth is expected to strengthen to 2.3% in 2018 and remain above 2% in 2019.

Graph 2.5: Germany - Real GDP growth and contributions



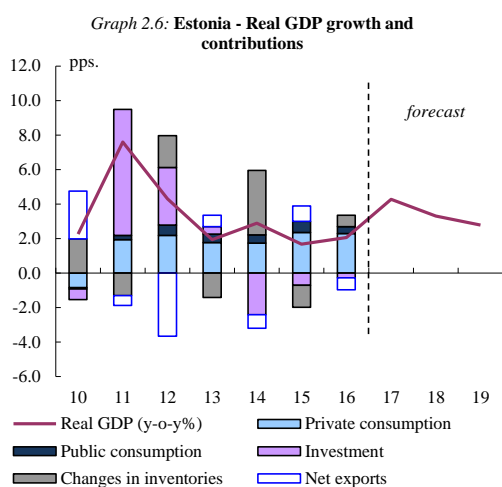
Price pressures were subdued between late 2014 and over most of 2016 as a result of the steep fall in oil prices and its second round effects on food and services prices. Inflation (HICP) picked up to 1.7% in 2017 and is expected to stay broadly stable, supported by increasing energy prices in 2018, and wage growth in 2019. Moderate inflation is expected to keep real wages high and support further household purchasing power.

2.6. ESTONIA: MODERATING GROWTH AFTER AN EXCEPTIONAL 2017

GDP growth was exceptionally high in 2017 and is expected to have reached 4.3%. Growth was broad-based overall but partly boosted by one-off factors including a surge in EU-funded investments and a rebound in the energy sector driven by higher global energy prices.

As the impulse from these one-off factors fades, GDP growth is expected to slow down over 2018 and 2019. Economic growth in Estonia should

nevertheless remain quite strong as both the external environment and domestic demand are set to remain very favourable. GDP growth is forecast to reach 3.3% in 2018 and 2.8% in 2019. In 2018, private consumption is set to receive a boost from a significant cut in personal income taxes targeted at low and middle-income earners, although this will be partly mitigated by higher excise taxes. Broad-based export growth is forecast to continue, while imports should be supported by strong domestic demand.



After three years of relatively low price increases, inflation peaked at 3.7% in 2017, driven by the rise in global prices for food and energy, which both have a relatively high share in Estonia's consumption basket. Increases in excise duties also contributed significantly to inflation in 2017 (almost 1 pp.). Overall, inflation is forecast to fall to 3.1% in 2018 and 2.6% in 2019, as global commodity prices are assumed to stabilise and the effect of higher excise taxes should weaken.

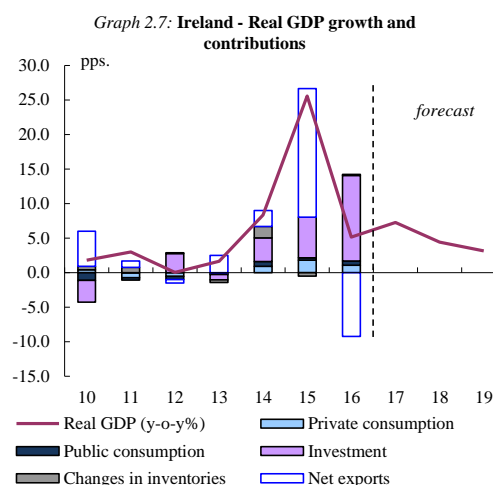
2.7. IRELAND: STRONG MOMENTUM AHEAD

Ireland's economy is expected to grow at a solid pace supported mainly by domestic activity. GDP growth performed better than expected in the third quarter of 2017 as headline figures were driven up by the activities of multinational companies in the country. Underlying domestic activity, which excludes some of the impact of multinationals, grew robustly by 4.9% in the first three quarters of 2017. GDP is estimated to have grown by 7.3% in 2017 and growth is expected to moderate to 4.4% in 2018 and 3.1% in 2019.

Consumer spending and construction investment are forecast to drive GDP growth in the short term. Strong employment growth, particularly for full-time jobs, should underpin a rise in disposable income and household consumption over the next two years. Supported by various government policies, investment in construction, both in the residential and commercial sectors, is projected to further contribute substantially to the economic expansion. However, headline investment figures are likely to remain volatile.

Trade figures remain heavily influenced by the activities of multinationals and are subject to high uncertainty. In 2018 and 2019, discounting for further volatility in contract manufacturing and imports of intellectual property services, exports are expected to increase in line with global trade and imports in line with strong consumer demand.

Inflation remains subdued and is forecast to pick up only gradually. In 2017, HICP inflation increased by just 0.3%, mainly due to the fall in the value of the pound, which lowered the prices of goods imported from the UK. This offset the strong growth in the price of services and energy. HICP inflation is forecast to rise to 0.9% in 2018, mainly driven by higher services and energy prices, and to 1.1% in 2019 with higher prices for services the prime driver. The negative effect of lower goods prices is expected to moderate.



Risks to the economic outlook are still mainly linked to the outcome of the negotiations between the UK and the EU, and potential changes to the international taxation environment.

Projections for 2019 are based on the technical assumption that trading relations between the

EU27 and the UK will maintain the status quo. This is for forecasting purposes only and has no bearing on the talks underway in the context of the Article 50 process.

2.8. GREECE: GROWING AGAIN

Greece's economy is growing again with real GDP expected to have reached 1.6% in 2017. The recovery is expected to strengthen in the coming years providing further support for employment growth. Sustained commitment to structural reforms remains vital to the continued expansion.

According to provisional data, real GDP in Greece grew by 0.3% (q-o-q) in the third quarter of 2017 (in seasonally-and working-day adjusted terms) corresponding to a growth of 1.1% (y-o-y) for the first three quarters of 2017. This marks the first time since 2006 that the Greek economy has grown for three consecutive quarters.

Net exports took over as the main driver of growth in the second and third quarters, signalling that Greece is also benefiting from the wider recovery in Europe and the improvements in the country's competitiveness achieved by structural reforms. Private consumption growth was broadly flat during the first three quarters of 2017, which somewhat narrowed the savings gap. The decline in investment was likely linked to adverse effects resulting from the delayed closure of the second review of the European Stability Support Programme in the third quarter.

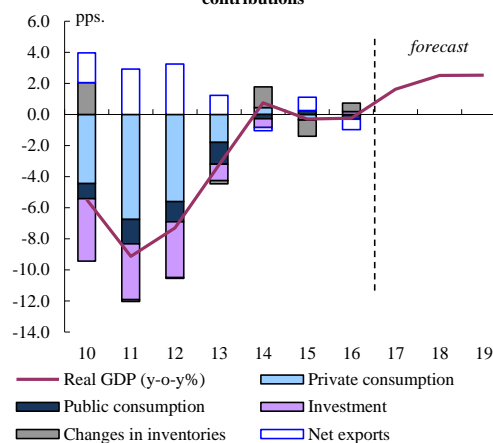
Real GDP is forecast to reach 2.5% in both 2018 and 2019. Sustained improvement in the labour market and in consumer sentiment is set to fuel private consumption growth. The business climate in Greece is also expected to improve further, although financing conditions may ease only gradually, leading to moderate investment growth. In 2019 investment is projected to grow more dynamically and is set to become an important positive contributor to growth. Robust foreign demand should provide a boost to net exports, which are projected to become an important growth-engine in 2018, supporting the economy's re-orientation towards the tradable sector.

The labour market continues to improve, with the unemployment rate having fallen to 20.7% in October 2017, down 2.7 pps. since the end of 2016. The improvement was driven by the increase

in employment, as the size of the labour force was broadly stable. According to quarterly national accounts data, employment rose by 1.8% (y-o-y) in the first three quarters of 2017. Employment is expected to continue growing, in line with the economic recovery.

Consumer price inflation reached 1.1% in 2017, driven by the rebound in energy prices and increases in indirect taxation. Headline inflation is expected to decrease in 2018, as core inflation looks unlikely to fully compensate for fading base effects linked to energy prices.

Graph 2.8: Greece - Real GDP growth and contributions



2.9. SPAIN: UPWARD REVISION TO GROWTH IN 2018

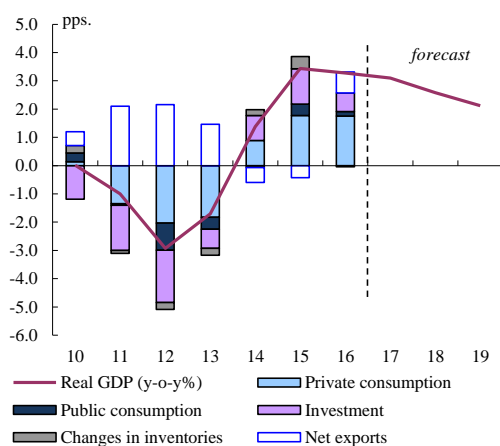
At 0.8%, quarterly GDP growth was strong in the third quarter of 2017, driven by strong private consumption, buoyant equipment investment and positive, but declining contribution of net exports to growth. According to the GDP flash estimate, growth slightly decreased to 0.7% (q-o-q) during the fourth quarter, bringing the annual growth rate for 2017 to 3.1%.

The strong growth momentum in the second half of 2017 has resulted in a higher growth carry over into 2018 than anticipated in the autumn forecast, and an upward revision to growth this year, to 2.6%. Growth is expected to ease over the forecast horizon, to an annual of 2.1% in 2019. Although the consequences for growth of recent events in Catalonia have remained contained, future developments could still have an impact, the size of which cannot be anticipated at this stage.

Private consumption growth is expected to slow down as the pace of job creation moderates but should nevertheless remain the main driver of GDP growth. Labour market indicators show conflicting signals, with administrative employment data showing a more positive outlook than the labour force survey. At the same time, other factors that supported the growth of household consumption in recent years, such as the improvement in financial conditions, are expected to fade away, while higher oil prices could act as a drag on disposable incomes. Residential construction and equipment investment growth are set to ease gradually, the latter in line with the projected slowdown in final demand.

Exports are set to continue growing dynamically but at slightly lower rates in 2018 and 2019, as gains in export market shares should slow down. At the same time, import growth is expected to remain broadly stable, evolving in line with fundamentals. As exports are expected to continue growing faster than imports, the contribution of the external sector is expected to remain positive, but become smaller over the forecast period.

Graph 2.9: Spain - Real GDP growth and contributions



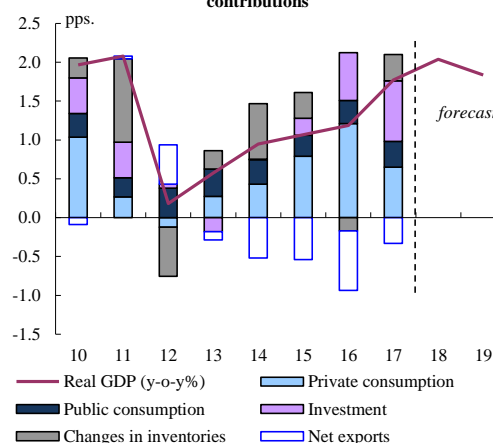
After moderating in the second half of last year, headline inflation is expected to increase again in the first half of this year before declining towards the end of 2018 due to base effects from oil prices, reaching an annual average of 1.6%. HICP is then expected to decline to an annual average of 1.5% in 2019 as oil prices decline again. Core inflation should recover gradually over the forecast horizon as wages pick up and the output gap turns firmly positive.

2.10. FRANCE: GROWTH IN HIGHER GEAR

GDP growth reached 0.6% in the fourth quarter of last year, thus growing at more than 0.5% for the fifth consecutive quarter. As a result, annual GDP growth increased sharply to 1.8% in 2017 from 1.2% in 2016⁽¹⁵⁾. In 2017, economic activity was primarily driven by strong private investment growth. Household investment grew at a sustained pace, recovering strongly after several years of contraction. In addition, corporate investment held up remarkably well following the end of the over-amortisation scheme, a fiscal incentive for firms to invest. However, private consumption growth declined as higher inflation ate into households' purchasing power. Net exports detracted from growth, while changes in inventories contributed positively.

Economic momentum is set to remain strong in the near future. GDP growth in France is forecast at 0.5% in the first quarter of 2018. Economic sentiment has continued to improve in recent months, with some confidence indicators approaching or even exceeding their pre-crisis peaks. As a result, GDP growth is expected to reach 2.0% in 2018 before easing to 1.8% in 2019 as spare capacities in the economy are reabsorbed.

Graph 2.10: France - Real GDP growth and contributions



Private consumption growth is set to recover somewhat after subdued growth in 2017, in line with disposable income. Investment growth is expected to rise further in 2018. Household investment is set to remain strong, as indicated by the increase in new construction starts. Moreover, public investment is set to rebound in 2018 after several years of contraction. Exports should

⁽¹⁵⁾ The GDP growth figures are non-calendar adjusted. In 2017, calendar adjusted GDP growth reached 1.9%.

accelerate in a context of sustained global demand. Meanwhile, import growth is expected to moderate slightly.

Unemployment in France is expected to continue falling, in line with the economy's growing strength. However, employment growth is set to moderate somewhat after strong growth in 2017, as the effects of past cuts to the labour tax wedge fade.

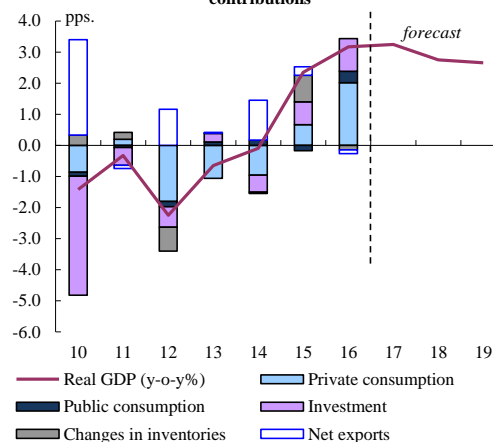
Inflation is forecast to reach 1.5% in both 2018 and 2019, up from 1.2% in 2017. Higher oil prices are expected to feed into higher headline inflation in 2018. Due to strong base effects, inflation is set to peak at 1.7% in the third quarter of 2018, before moderating again. In 2019, second round effects from higher energy prices and a tighter labour market are set to stoke a gradual recovery in core inflation.

2.11. CROATIA: PACE OF RECOVERY MODERATES

As the economy enters its fourth year of recovery, growth is expected to remain solid and broad-based. Following revisions to the national accounts, real GDP growth in 2016 is now reported at 3.2%, 0.3 pps higher than before. This rate of growth was likely maintained in 2017, as economic activity was strong in the first three quarters of the year and some high frequency indicators point to a slowdown in the last quarter. Slower momentum in Q4 will likely carry over to 2018, with real GDP growth forecast at 2.8%, and 2.7% in 2019. At this pace, the economy is set to reach its pre-recession volume of output by the end of 2019.

Private consumption remains the main engine of growth, with rising wages and employment spurring disposable income and consumer confidence. In 2017, the recovery in investment was curbed by the crisis in the distressed food-processing and retail giant Agrokor. However, investment is expected to pick up as credit activity is growing in the corporate sector, although the outcome of Agrokor's operational and financial restructuring still presents risks. Indicators for 2017 point to another record season in tourism, but goods exports also performed strongly. Overall, net exports are expected to weigh on growth as strong domestic demand fuels demand for imports.

Graph 2.11: Croatia - Real GDP growth and contributions



Employment is increasing steadily, while the previously recorded sharp declines in the unemployment rate are expected to ease in line with the expected slowdown in net outbound migration. Tightening labour market conditions, particularly in sectors with labour shortages, and wage hikes in the public sector, are expected to keep wages on the rise. Further inflationary pressures are expected from energy prices. Overall, HICP inflation reached 1.3% in 2017 and is forecast to continue rising, with core inflation picking up towards the end of the forecast horizon.

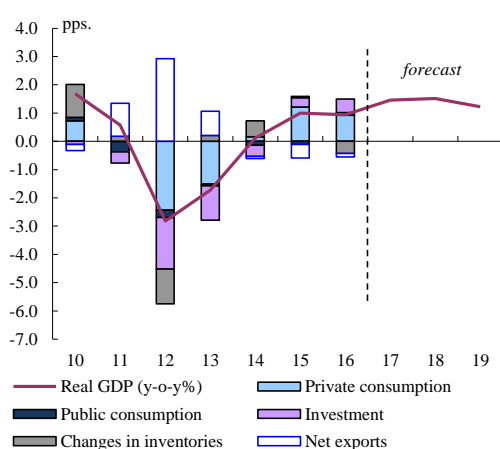
2.12. ITALY: RECOVERY PICKS UP SLIGHTLY

Italy's economy continues to benefit from the global cyclical upswing and stronger domestic demand. In the first three quarters of 2017, real output grew by an average of 0.4% (q-o-q). Survey indicators and short-term business statistics suggest that the economy maintained its growth momentum at the turn of the year. Favourable economic conditions will carry over into 2018, before tailwinds are expected to abate in line with the gradual withdrawal of policy stimulus. Although Italy's recovery is set to become more self-sustained, its growth prospects remain moderate, given the Italian economy's limited growth potential. Domestic downside risks largely relate to the still fragile state of the Italian banking sector, while there is an upside risk that the recovery could strengthen more than envisaged, at least in the near term. The projections are based on the no-policy-change assumption that Italy continues to implement already adopted growth-friendly reforms and pursues prudent fiscal policies.

Real GDP growth in 2017 is estimated at 1.5% in 2017, the same as it was in the autumn forecast. Overall, domestic demand remained the main engine of growth as household consumption was supported by rising employment and consumer confidence. In addition, investment growth was bolstered by favourable financing conditions and tax credits but was also associated with a marked pick-up in exports of goods and services.

The external environment is projected to remain supportive and signs that wage growth was slowly accelerating in the second half of 2017 bode well for consumer spending in the near future. In 2018, real GDP is forecast to expand by 1.5%, led by exports and investment. Private consumption is expected to support growth at a moderate but stable rate, underpinned by rising wages in both the private and the public sector, and employment growth. With the output gap closed and the economy gradually returning to more moderate long-term growth rates, real GDP growth is predicted to slow to 1.2% in 2019.

Graph 2.12: Italy - Real GDP growth and contributions



Headline annual HICP inflation averaged 1.3% in 2017, as services prices rose less quickly in the final quarter of the year. The upward pressure on consumer prices in 2018 due to rising oil prices should be broadly offset by base effects associated with unprocessed foods and services. Annual HICP inflation is expected to increase to 1.5% by 2019. Core inflation slowed down in line with prices for services in the last quarter of 2017 but is set to pick up gradually on the back of moderate wage growth and the recovery of profit margins.

2.13. CYPRUS: STRONG GROWTH MOMENTUM

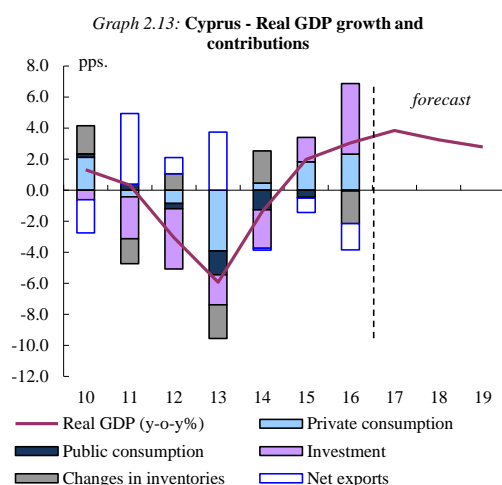
Cyprus is experiencing a very strong recovery. Quarterly GDP growth in the third quarter of last year was just as solid as in the first half of the year. Available 'soft' and early 'hard' data point to healthy growth in the fourth quarter as well. Overall, in 2017 growth is expected to have reached 3.8%, making Cyprus one of the fastest growing economies in the euro area. Growth is expected to moderate in 2018 and 2019, to 3.2% and 2.8% respectively.

The economy's robust performance can be attributed to strong private consumption and solid export growth, as well as some support from public consumption. Private consumption benefitted from rapidly expanding employment across all sectors (which led to a marked decline in unemployment, including long-term unemployment) and rising compensation per employee. Wages and employment are expected to continue growing into 2018 and 2019, supporting private consumption.

Exports of services were strong, especially in the second and third quarters of 2017, linked to the ongoing tourism boom in Cyprus. This coincided with a certain rebound in goods exports. Meanwhile, import growth was more moderate in the first three quarters of 2017 (compared to 2016, when imports and investment were heavily influenced by one-offs related to ship purchases), but both investment and imports are expected to have picked up in the last quarter of the year. After the surge in 2016, investment levelled off in 2017. It is projected to pick up in 2018, on the back of buoyant residential construction and plans for large tourism projects. In 2019, import growth is expected to strengthen, driven by rising consumption and investment, while export growth is set to slow given limited opportunities for further growth, especially in tourism where capacity constraints may become binding.

Inflation surprised on the downside, with HICP at 0.7% in 2017. Inflation was mainly driven by energy prices, while prices of processed and non-processed foods and industrial goods declined in the second half of the year. After two years in negative territory, core inflation turned marginally positive in 2017 due to higher service prices linked to increasing wages. Inflation in 2018 is expected to climb to 1.2%, mainly as a result of higher oil

prices, and to 1.3% in 2019, amid higher domestic price pressures stemming from wage dynamics.

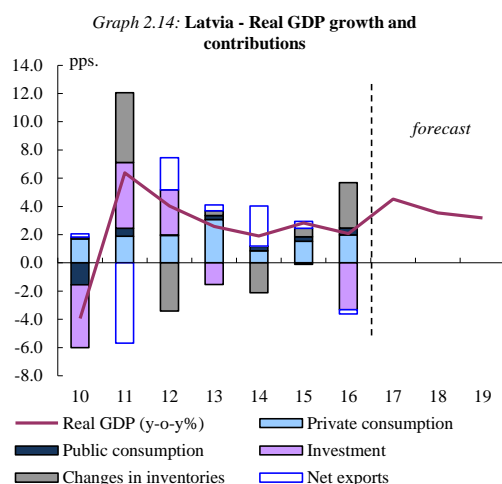


investment wears off and the tight labour market offers little room for employment growth. By contrast, growing optimism in Latvia's main external markets is expected to fuel export growth in 2018. Wages are set to continue growing strongly as the size of the active population shrinks and a substantial increase in the minimum wage is introduced. The latter, combined with a notable increase in excise duties is forecast to push inflation above 3% in 2018.

GDP growth is expected to slow down further to 3.2% in 2019, as both private consumption and investment moderate. While wage growth is forecast to remain strong, inflation – expected to remain at around 3% – is set to dampen the growth of real disposable incomes and therefore private consumption. With domestic demand cooling off, exports are set to be the main growth driver in 2019.

2.14. LATVIA: SOLID GROWTH ON THE HORIZON

Buoyant private consumption, driven by rapid wage growth and a steep recovery in EU-funded investments is expected to have pushed GDP growth to 4.5% in 2017. While consumption and investment growth strengthened in 2017, export growth disappointed, especially given the improving external outlook. Due to shrinking labour force, the unemployment rate continued to decrease, but the number of people employed barely changed. Inflation approached 3%, driven by a moderate recovery in energy prices and rapid wage growth.



With 3.5% forecast GDP growth, the strong momentum is expected to carry on into 2018, albeit at a slowing pace, as a one-off boost of

2.15. LITHUANIA: CHANGING GROWTH DRIVERS IN 2018

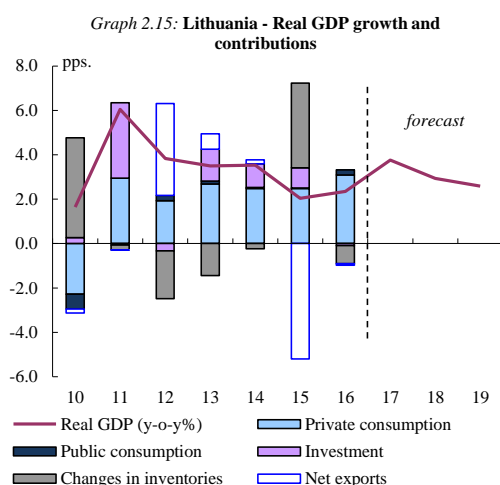
Real GDP is expected to have grown by 3.8% in 2017, compared to 2.3% in 2016. Favourable international trade conditions helped Lithuania's exports to reach double-digit growth in 2017, especially in the service sector. The contribution of net exports to real GDP growth is expected to have been close to neutral as imports, especially of capital goods and crude oil, also picked up.

Growth was also strongly supported by private investment as companies started expanding their capacities to meet increased demand and adjusting to the shortage of labour via automation. Public investment remained muted, as usage of EU funds failed to gather pace.

Private consumption also proved to be an important growth factor, primarily due to an overall high wage increase, although this was partly offset by the elevated inflation rate.

In 2018 and 2019, GDP growth is forecast to moderate to 2.9% and 2.6% respectively, as exports and consumption are set to slow down. However, in 2018, investment is expected to push the economy up slightly more than in 2017, as more EU investment funding gets used and companies step up their investment in advanced technologies to offset the effects the shrinking

labour force. Imports are set to remain in step with exports as the latter are highly import-dependent.



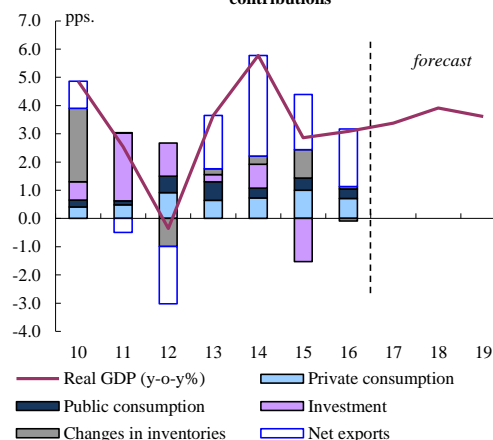
HICP inflation reached 3.7% in 2017, fuelled by the rise in global energy prices and excise duties, as well as a notable rise in service prices linked to significant wage increases. Inflation is set to moderately fall to 2.9% in 2018 and decrease further to 2.5% in 2019. Energy prices and wage growth are expected to be the main drivers of price increases over the forecast horizon.

2.16. LUXEMBOURG: STRONG, BROAD-BASED GROWTH

Economic growth is projected to pick up in 2018, before easing slightly in 2019. Luxembourg's GDP growth is estimated to have reached 3.4% in 2017, up from 3.1% in 2016. After a weak performance in the first quarter of last year, economic activity gained momentum in the second and third quarters. The latest indicators suggest that this trend likely continued in the final quarter of the year.

Private consumption is projected to continue growing moderately in 2018, mainly supported by stronger employment creation among residents and some income gains from the wage indexation expected in the first half of 2018. However, household high indebtedness and increasing debt burdens, might be affecting consumption growth. Construction investment is set to continue growing strongly, sustained by steady growing private building and large public infrastructure projects. The external sector is expected to remain solid, supported by an improved external environment, especially in the euro area. Overall, GDP is forecast to grow by 3.9% in 2018.

Graph 2.16: Luxembourg - Real GDP growth and contributions



In 2019, consumption growth is expected to ease slightly, with employment creation moderating and higher underlying inflation taking a dent on income gains from the wage indexation. The external sector, led by financial services exports, is expected to remain robust, even if receding, in line with financial market prospects.

Headline HICP inflation reached 2.1% in 2017 and is forecast to ease to 1.9% in 2018 and 1.6% in 2019. Higher oil prices are assumed to feed into higher headline inflation in 2018, whereas subsidies in child and healthcare services care introduced in November 2017 will offset upward energy pressures. In 2019, second round effects from higher energy prices and past wage increases are set to lead to a recovery in core inflation.

2.17. HUNGARY: MATURING CYCLE DRIVEN BY DOMESTIC DEMAND

Growth picked up in 2017 following a temporary lull in 2016. Hungary's real GDP is estimated to have increased by 3.8% in 2017 on the back of strong domestic demand.

Consumer confidence remained high and private consumption was supported by rapid wage rises and continued employment growth. Gross fixed capital formation grew by more than 20% year-on-year in the first three quarters of 2017. The main driver of the acceleration was the resumption of EU fund absorption under the new multiannual financial framework. Business and household investment also increased dynamically as the global economic recovery improved the prospects

for businesses and strong demand for new homes spurred residential construction. Fiscal policy measures and favourable financing conditions further supported domestic demand. Trade flows accelerated in 2017, when net exports contributed negatively to GDP growth. However, the current account remained in surplus.

Strong growth is set to continue over the forecast horizon. GDP is projected to increase by 3.7% in 2018 and 3.1% in 2019. Private consumption and investment are expected to grow strongly in 2018, boosted by government-initiated and market-driven wage increases, and supported by a strong recovery in bank lending. Corporate and public investment are set to continue growing at double-digit rates, as EU-funded projects are implemented. At the same time, strong domestic demand is expected to lead to rapid import growth. In 2019, economic growth is projected to slow down as a result of capacity constraints in particular on the labour market, decelerating growth of real disposable income and slower growth in export demand as the economic expansion matures in the EU.

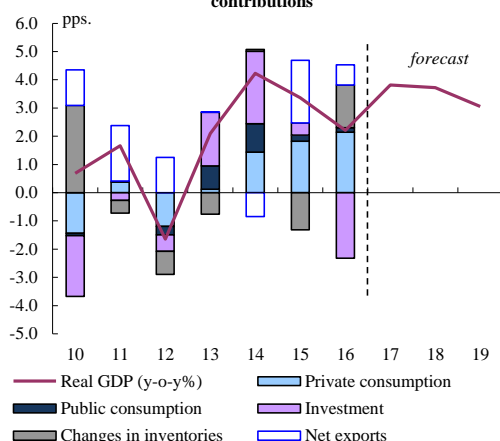
Headline inflation increased sharply in 2017 to 2.4% from 0.4% in 2016, on the back of strong domestic demand. Inflation is forecast to rise further to 2.8% in 2018 and 2.9% in 2019, levels near to the central bank's target of 3.0%. Inflation is expected to be broad-based, as energy prices rise and service price increases pick up on the back of strong wage growth.

2.18. MALTA: GROWTH CONTINUES AT A SUSTAINED PACE

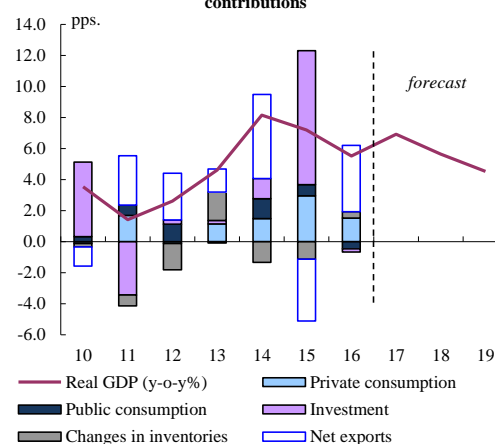
Real GDP grew strongly in the first three quarters of 2017 and continued to surprise on the upside, reaching 7.2%. The external sector, driven by growing services exports, remained the main driver of growth in 2017. Domestic demand was affected by a strong contraction in investment, linked to a high base effect from an extraordinary investment in transport equipment in 2016. Residential construction, by contrast, continued to increase robustly. Following a rebound in imports in the last quarter of the year, real GDP growth is expected to have reached 6.9% for 2017 as a whole, above the rate recorded in 2016. The dynamics in the external sector are pushing up the current account surplus.

Economic growth is projected to slow in 2018 to 5.6%. Private consumption is expected to become the main driver of growth on the back of strong employment growth, improved consumer confidence and growing disposable income. Investment is forecast to recover, led by the residential construction sector, which is expected to continue growing strongly in 2018. Driven by domestic demand, imports of goods and services are gaining momentum, and exports are forecast to continue rising, in line with growing demand in Malta's main trading partners. Overall, the current account surplus is expected to stabilise.

Graph 2.17: Hungary - Real GDP growth and contributions



Graph 2.18: Malta - Real GDP growth and contributions



In 2019, real GDP growth is projected to moderate further to 4.5%. Private consumption is projected to remain the main driver of growth, while investment is expected to increase mainly on the back of the construction sector. Net exports are

expected to contribute only modestly to GDP growth, as domestic demand fuels imports.

Headline annual HICP inflation averaged 1.3% in 2017, slightly lower than the euro area average. Relatively moderate increases in regulated fuel prices have contained overall HICP inflation. Inflation is projected to strengthen to 1.5% in 2018 and 1.8% in 2019. Higher price growth is expected to come mainly from the services component, which is projected to rise in line with growing disposable incomes.

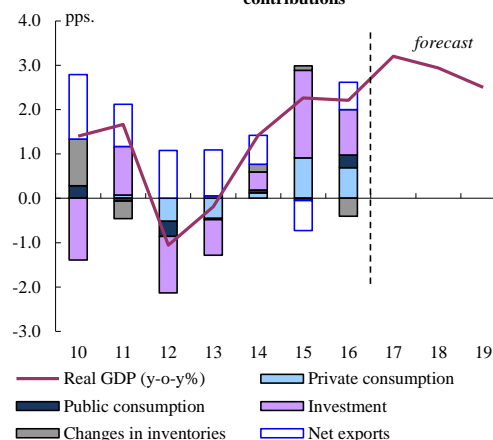
2.19. THE NETHERLANDS: ROBUST EXPANSION TO CONTINUE

Economic growth is expected to have reached 3.2% in 2017, with business and consumer survey data and monthly figures suggesting that the economy's strong performance continued in the fourth quarter and at the start of this year. The forecast for real GDP growth in 2018 and 2019 remains robust 2.9% and 2.5% respectively.

Private consumption and investment are the main growth drivers in the current phase of the business cycle. Wage and employment growth are feeding household disposable incomes, encouraging higher consumption. Private consumption is also benefiting from positive wealth effects stemming from rising house prices. Companies are expected to invest more in equipment now that capacity utilisation rates have returned to pre-crisis levels. However, this will likely be partly offset by a slowdown in residential investment as the housing market moderates. The new government's expansionary fiscal plans imply an increase in public consumption and provide an extra boost to domestic demand. Net exports are expected to contribute only moderately to GDP growth, as buoyant domestic demand should lead to strong import growth.

The labour market is getting tighter and wage growth is accelerating, partly as a result of higher wage demands by trade unions. Higher wage growth is expected to lead to higher prices for services. Increasing oil prices are expected to drive up domestic energy prices. All in all, HICP inflation is set to increase to 1.6% in 2018 after having reached 1.3% in 2017. In 2019, inflation is set to accelerate to 2.3% as planned increases in indirect taxes (VAT and energy taxes) kick in.

Graph 2.19: The Netherlands - Real GDP growth and contributions



2.20. AUSTRIA: STRONG GROWTH DYNAMICS STABILISING

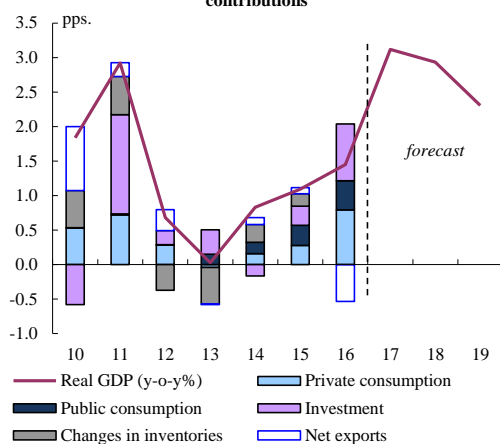
Austria's economy likely grew twice as fast in 2017 as it did in 2016. Another quarter of strong GDP growth at the end of 2017 suggests real GDP growth of 3.1% for the year as a whole, compared to 1.5% in 2016. Optimistic business and consumer sentiment indicators suggest that economic growth should remain strong in 2018 (2.9%) before easing somewhat in 2019 to 2.3%.

Austria has clearly benefited from the strengthening of world trade and additional demand from neighbouring countries. After moderate growth in 2016 (1.9%), exports are likely to have increased by more than 5% in 2017. As Austria is well integrated into global value chains, imports also increased noticeably. Growth was driven predominantly by domestic demand with strong investment, particularly in machinery and equipment, as well as construction. Companies are seeing higher levels of capacity utilisation and have started expanding their production bases as well as making replacement investments. Private consumption was also strong - still benefitting somewhat from tax reforms in 2016.

In 2018 and 2019, investment is set to continue supporting growth but to a lesser extent. Private consumption is expected to stay stable as good labour market conditions and falling unemployment contribute to supporting household disposable incomes. Exports should grow robustly on the back of the favourable outlook for world trade but their growth rate is expected to moderate slightly over the next two years.

HICP inflation increased markedly to 2.2% in 2017, driven not only by stronger oil prices but also by price increases for industrial goods, restaurant, hotels, plane tickets and rents. Headline inflation has thus more than doubled compared to 2016 (1.0%) and remains visibly above the euro area average. Similarly, core inflation increased noticeably to 2.2% in 2017, after 1.5% the year before. In 2018, HICP and core inflation are expected to stabilise at around 2.1% before decreasing slightly in 2019.

Graph 2.20: Austria - Real GDP growth and contributions



2.21. POLAND: SOLID GROWTH DRIVEN BY DOMESTIC DEMAND

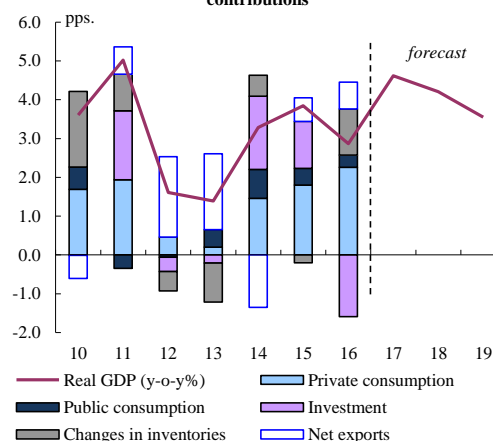
Economic growth remained buoyant in 2017. GDP grew by 1.2% (q-o-q) in the third quarter and by an estimated 4.6% in 2017 as a whole. Private consumption was the main growth driver. Having risen in the second half of the year, investment activity partly rebounded from the decline in 2016. Public investment is expected to have recovered from a 2016 slump, while private investment trends varied across sectors: growth was strong in some services sectors but manufacturing investment was weak. Export activity was volatile in the first two quarters of 2017 but strengthened in the second half of the year. Import growth followed a similar pattern. Consequently, the growth contribution of net exports was most likely broadly neutral.

Real GDP growth is forecast to remain strong at 4.2% in 2018 and 3.6% in 2019. The growth composition is expected to remain similar to 2017, with domestic demand providing the strongest contribution. Private consumption is projected to be supported by faster wage growth and record-

high consumer confidence. Investment is expected to continue a gradual recovery, driven by a strong rebound of public investment, especially in 2018.

Having averaged 1.6% in 2017, inflation is projected to rise to 2.1% in 2018 and 2.6% in 2019. Core inflation, in particular services prices, is set to gradually rise between 2018 and 2019 to over 2.5% in the second half of 2019. A tight labour market and intensifying wage pressures are expected to be key drivers for core inflation, whereas headline inflation will continue to be strongly affected by assumed fluctuations in prices for energy and unprocessed food.

Graph 2.21: Poland - Real GDP growth and contributions

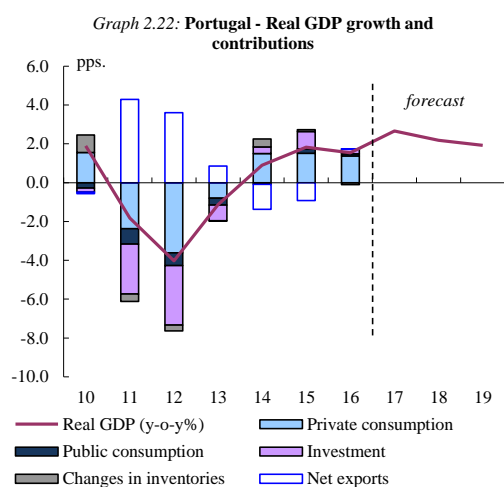


2.22. PORTUGAL: GROWTH CONSOLIDATES

Economic growth picked up to 2.9% (y-o-y) in the first half of 2017 and moderated to 2.5% in the third quarter of 2017. Private consumption growth strengthened in the third quarter of 2017 underpinned by a pick-up in purchases of durables. However, it is expected to slow down somewhat in the coming quarters as a result of moderate wage developments and a small increase in the saving rate. Investment should continue to support growth as it benefits from improved financing conditions, increased capacity utilisation rates and higher corporate profits. Both exports and imports performed strongly in 2017, reflecting the upbeat economic sentiment across Europe and the capacity upgrade in Portugal's largest car producer. Foreign trade is expected to moderate somewhat over the forecast horizon but should still grow faster than domestic demand, whose contribution to growth is likely to drop after a very strong performance in 2017. Overall, GDP growth

is estimated at 2.7% in 2017, and forecast to slow down to 2.2% in 2018 and 1.9% in 2019.

Employment continued to grow faster than GDP in 2017. Strong job creation in labour-intensive sectors, particularly in tourism, contributed to weak productivity performance, although this is expected to improve in 2018 and 2019. The job-rich recovery reduced substantially both headline and long-term unemployment to their lowest levels since 2004.



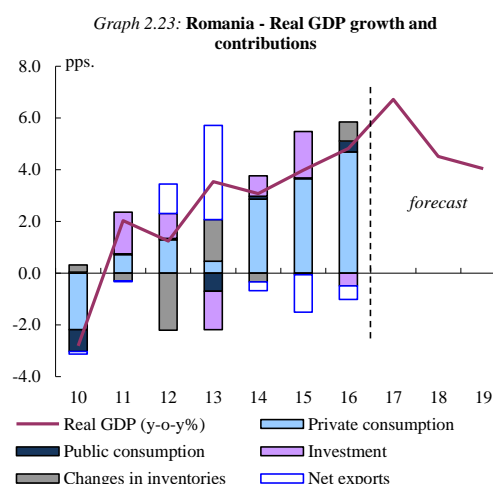
Consumer price inflation reached 1.6% in 2017, driven mainly by energy and services, while prices of non-energy industrial goods declined. Headline inflation is expected to stabilise at 1.6% in 2018 and to drop slightly to 1.5% in 2019. Energy prices are set to make a major contribution to inflation in 2018, reflecting oil price movements, while the strengthening of the euro is projected to keep the prices of non-energy industrial goods on a declining path. In 2019, the impact of energy is assumed to fade away, while inflation in services is set to pick up slightly along with the increase in disposable incomes. Accordingly, core inflation is set to remain slightly below the headline rate in 2018 and to move above it in 2019.

2.23. ROMANIA: CONSUMPTION-DRIVEN BOOM

Economic growth in Romania accelerated in 2017, with real GDP estimated to have grown by 6.7% (y-o-y) - a post-crisis high. The main driver of growth was private consumption, supported by indirect tax cuts and wage hikes both in the public and the private sectors. After contracting in 2016, total investment started to grow again in 2017. Its

pace of recovery, however, remained subdued as public investment fell sharply for the second consecutive year. The boom in private consumption has led to an increase in imports. As a consequence, net exports have acted as a drag on real GDP growth, despite relatively strong export growth.

Looking ahead, GDP growth is forecast to decelerate to 4.5% in 2018 and 4.0% in 2019. The growth of private consumption is expected to be more tempered in 2018, as inflation weighs more heavily on real disposable incomes and wage growth slows down. Nevertheless, private consumption is expected to continue acting as the main growth driver over the forecast horizon. Investment is forecast to strengthen on the back of a pick-up in the implementation of projects financed by EU funds.



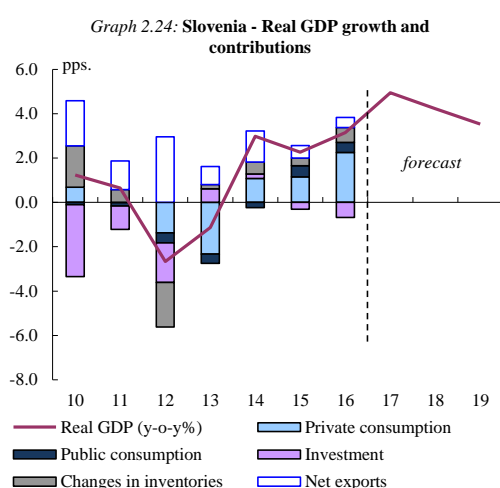
Labour market conditions have been improving in line with the economic expansion. In 2017, the unemployment rate dropped to its lowest level in more than 20 years. The tight labour market, together with a 16% minimum wage hike in February 2017 and public sector wage increases, led to faster wage growth. Overall, average net wages are estimated to have increased by around 13% in real terms in 2017. Real wages are expected to continue growing in 2018, albeit at a slower pace, due to further increases in public wages and an additional 9% hike in the net minimum wage taking effect in January.

After two consecutive years of falling consumer prices, inflation turned positive in 2017, despite being dampened by VAT rate cuts and lower excise duties on fuel. Inflation started to accelerate in the second half of the year, mainly on account

of rising food and energy prices. In December 2017, HICP inflation was 2.6% (y-o-y), while core inflation stood at 1.9%. Headline inflation is projected to further pick up as demand pressures mount and the effect of the January 2017 tax cuts fades away. The reversal of the January excise duties cut in October 2017 should further push up inflation this year. Thus, inflation is forecast to be 4.1% in 2018 and 3% in 2019. As inflation re-entered its target band (2.5% \pm 1 pp.), the National Bank of Romania has started to tighten its highly accommodative monetary policy. In January 2018, the key monetary policy rate was raised by 0.25 pps. to 2%, the first rate hike since 2008.

2.24. SLOVENIA: BALANCED GROWTH PATH

Slovenia's economy continued to grow at a strong pace in the first three quarters of 2017. Real GDP increased by 5.1% compared to the first three quarters of 2016. Growth was mainly driven by domestic demand but also net exports. In particular, there was strong growth in public as well as private investment. Private and public consumption also increased, boosted by growing disposable income and upbeat consumer confidence. Thanks to the favourable external environment, export growth remained buoyant and outpaced import growth. Strong confidence indicates that solid growth in all components continued in the final quarter of the year, leading to an estimated real GDP increase of 4.9% in 2017.



Real GDP growth is forecast to reach 4.2% in 2018, as domestic demand remains strong but the contribution from net exports declines. As employment and wages grow and bank lending becomes more readily available, private

consumption is expected to expand strongly. Strong demand, high capacity utilisation, as well as improving corporate balance sheets and credit conditions underpin the expected high growth of investment in productive capacity. Growth in construction investment is also expected to accelerate, as demand for new housing as well as the need for commercial and industrial spaces grow. The improved take-up of EU funds is set to boost investment further. The same positive factors are expected to continue in 2019, but the strength of domestic demand means that imports should grow faster than exports, resulting in lower GDP growth of 3.5%.

HICP inflation was 1.6% in 2017. Due to the increases in energy and services prices, inflation is set to accelerate to 1.8% in 2018. In 2019, when the labour market tightens further, headline inflation is projected to reach 2.0%.

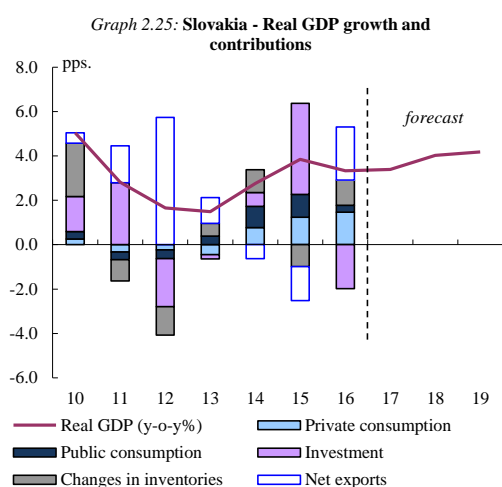
2.25. SLOVAKIA: GROWTH STRENGTHENS, INFLATION PICKS UP

Slovakia's economic growth is projected to have strengthened marginally to 3.4% in 2017, driven by higher household spending and a recovery in investment. Further improvements in labour market conditions and buoyant investment activity in the private sector are set to foster economic expansion in 2018 and thereafter. Real GDP growth is projected to gradually increase to over 4% in 2019, backed by positive contributions from net trade, which should benefit from expanded production capacities in the car industry and strong external demand.

Investment surged by 6.2% on a quarterly basis in the third quarter of 2017, suggesting a firm recovery in 2017 as a whole after a sharp downfall in the previous year that was linked to the EU funds cycle. Overall, investment growth is expected to peak in 2018, driven by booming investment in the automotive industry and some large-scale public infrastructure projects. However, the relatively slow take-up of investment funding offered by the EU under the current funding period (2014-2020) poses a downward risk to the investment outlook in the near term, especially as EU funds have proven to be a major driver of both public and private investment activity.

Continued employment gains and broad-based wage growth are expected to bolster household

budgets in spite of increasing inflation. The unemployment rate is set to gradually decline, indicating a further tightening in the labour market. Nominal wage growth is likely to strengthen throughout 2018 and remain solid in 2019, driven in part by a surge in labour shortages and reviving consumer prices. Recent wage increases were broad-based across sectors, providing support to household budgets and future private spending. Indeed, the retail trade index has continued to climb in recent months and consumers' reported willingness-to-buy remains elevated.



Consumer inflation revived to 1.4% in 2017, with prices of food and services being the key drivers of the recovery. Inflation is set to increase gradually over the coming quarters, bringing the annual average to around 2% in 2018 and 2019. This mainly reflects expected increases in the prices of services in line with rising wages and buoyant private demand, and higher assumed energy prices in 2018.

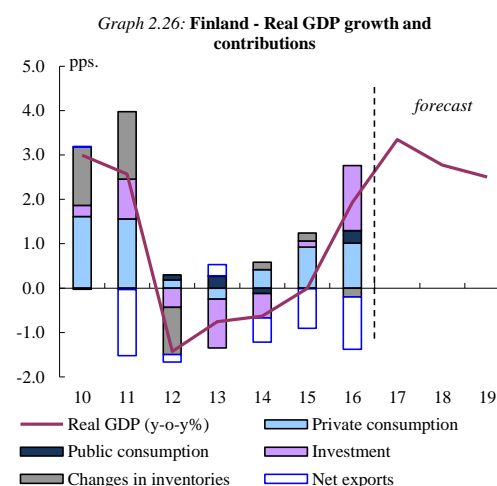
2.26. FINLAND: ROBUST GROWTH CONTINUES

Finland's economy grew an estimate 3.3% in 2017, faster than the EU and euro area averages. Growth was supported by net exports as well as higher investment and robust private consumption.

Over the forecast period, the expansion is set to remain solid and broad-based across sectors. GDP growth is forecast to ease to 2.8% in 2018. Domestic demand is expected to be the main contributor. Private consumption is projected to expand further, reflecting the increase in household disposable income, the improved situation in the labour market and the historically

high level of consumer and business confidence. High investment growth is expected to continue, in line with rising exports, favourable financing conditions and positive trends in the global economy. Housing construction is set to continue growing in 2018 and 2019.

High demand in the economies of the main trading partners and improved cost competitiveness are expected to support all traditional export sectors. During the forecast period, the positive contribution of net exports to GDP growth should decline gradually, in line with the slowing of growth in world trade in 2019 and due to increasing imports, which reflect growing investment and increasing domestic consumption.



In 2019, GDP growth is forecast at 2.5%. The expected moderation reflects a slowdown in the growth of private consumption. Private investment and the contribution from net exports are set to remain strong.

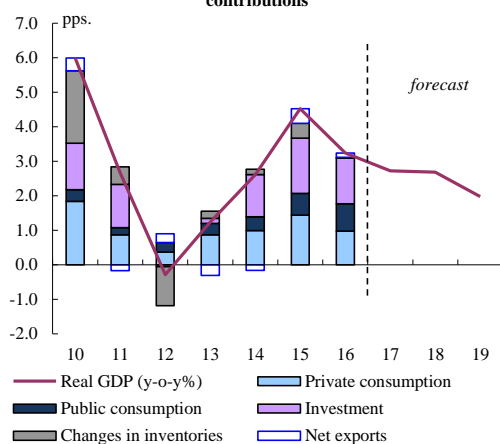
Employment creation strengthened in 2017 as a result of robust economic activity and further improvement is expected in 2018, as the economic expansion continues. However, unemployment is set to fall very slowly and to remain relatively high in 2018 and 2019, partly due to increasing labour supply.

After reaching 0.8% in 2017, inflation is forecast to pick up gradually, driven by an increase in service and energy prices. Annual HICP inflation is forecast to reach 1.4% in 2018 and 1.6% in 2019 with service prices continuing to have the largest impact on overall inflation.

2.27. SWEDEN: SOLID GROWTH WITH NEAR TARGET INFLATION

Sweden's economy grew strongly by an estimated 2.7% in 2017, fuelled by robust domestic demand. Investment, driven by housing investment, grew 9.5% (y-o-y) in the first three quarters, making a particularly strong contribution. Although economic confidence edged down at the end of 2017, overall sentiment remained positive and above its long-term average.

Graph 2.27: Sweden - Real GDP growth and contributions



For 2018, growth is expected to expand at a similar pace. The recent fall in house prices is set to dampen residential investment but this effect is projected to be partially compensated by the stronger outlook for investment in machinery and equipment, than expected in the autumn. The Swedish krona's depreciation and the upsurge in global growth are set to lift exports. Private consumption should grow moderately, thanks to continuous growth in employment and allowances from the 2018 budget. In 2019, real GDP is forecast to slow to 2.0%, as domestic demand flattens and the economic cycle matures.

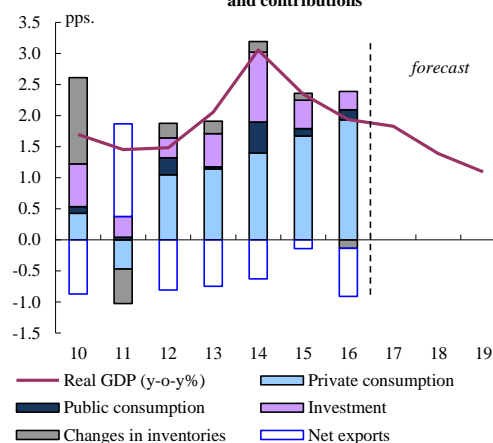
HICP inflation was 1.9% in 2017. While prices, in particular for services, picked-up in the first three quarters, this trend did not last and core inflation ended 2017 at 1.5%. Although capacity utilisation is high and skill shortages have been reported, wage growth has been subdued due to global competitive pressures, low wage expectations and untapped labour force. These trends are set to remain broadly intact; therefore headline inflation is set to hover around 1.8% in 2018 and 1.7% in 2019. This is slightly higher compared to autumn due to the recent increase in oil prices and the depreciation of the Swedish krona.

2.28. THE UNITED KINGDOM: OUTLOOK REMAINS RELATIVELY SUBDUED

Preliminary estimates for the last quarter suggest that the UK economy likely grew by 1.8% in 2017. Recent data revisions by the Office for National Statistics (ONS), affecting data as far back as the first quarter of 2016, have increased year-on-year growth rates in 2017, resulting from a statistical (carry-over) effect. Notwithstanding this effect, the significant slowdown seen in the quarterly growth rates in 2017 compared to the second half of 2016 is still evident.

The slowdown has been driven primarily by a decline in private consumption growth, due to a squeeze on real disposable incomes. Consumer prices rose sharply in 2017 following the 2016 depreciation of sterling. Private consumption growth in 2018 is expected to remain subdued alongside continued elevated inflation. Business investment growth also remains relatively weak despite very favourable conditions (including low financing costs and improving external demand), as heightened uncertainty is weighing on business investment.

Graph 2.28: The United Kingdom - Real GDP growth and contributions



Supported by the earlier depreciation of sterling and growth in main trading partners, notably in the euro area, the UK economy has benefited from buoyant trade. Exports grew by an average of 6.8% (y-o-y) in the first three quarters of 2017. Partially offsetting this, imports have grown by an average of 3.1% (y-o-y) in the same period. The boost from net trade is expected to moderate in 2018 as the impact of sterling's earlier depreciation unwinds. All these factors together mean GDP growth is expected to be 1.4% in 2018.

Under the current technical assumption, ⁽¹⁶⁾ GDP growth is expected to remain subdued at 1.1% in 2019. The positive effect of lower consumer price inflation on consumption is expected to be partially offset by an increase in the household savings rate. Business investment is projected to

remain relatively weak while net exports are forecast to moderate in line with export markets.

After averaging 2.7% in 2017, consumer price inflation is expected to remain elevated in 2018 at 2.7%, as the impact of the rise in oil prices feeds through to consumer prices. Inflation is projected to ease to 2.0% in 2019.

⁽¹⁶⁾ Given the ongoing negotiation on the terms of the UK withdrawal from the EU, projections for 2019 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 the talks underway in the context of the Article 50 process.

STATISTICAL ANNEX

Table 1: Gross domestic product, volume (percentage change on preceding year, 1999-2019)

30.01.2018

	5-year averages						Winter 2018 forecast			Autumn 2017 forecast		
	1999-03	2004-08	2009-13	2014	2015	2016	2017	2018	2019	2017	2018	2019
Belgium	2.1	2.5	0.5	1.4	1.4	1.5	1.7	1.8	1.7	1.7	1.8	1.7
Germany	1.2	2.0	0.6	1.9	1.7	1.9	2.2	2.3	2.1	2.2	2.1	2.0
Estonia	5.8	5.5	0.0	2.9	1.7	2.1	4.3	3.3	2.8	4.4	3.2	2.8
Ireland	7.0	3.8	0.3	8.3	25.6	5.1	7.3	4.4	3.1	4.8	3.9	3.1
Greece	4.2	2.8	-5.9	0.7	-0.3	-0.2	1.6	2.5	2.5	1.6	2.5	2.5
Spain	4.0	3.2	-1.8	1.4	3.4	3.3	3.1	2.6	2.1	3.1	2.5	2.1
France	2.2	1.9	0.4	0.9	1.1	1.2	1.8	2.0	1.8	1.6	1.7	1.6
Italy	1.5	1.0	-1.6	0.1	1.0	0.9	1.5	1.5	1.2	1.5	1.3	1.0
Cyprus	4.0	4.3	-1.9	-1.4	2.0	3.0	3.8	3.2	2.8	3.5	2.9	2.7
Latvia	6.0	7.3	-1.4	1.9	2.8	2.1	4.5	3.5	3.2	4.2	3.5	3.2
Lithuania	5.2	7.0	-0.3	3.5	2.0	2.3	3.8	2.9	2.6	3.8	2.9	2.6
Luxembourg	4.9	3.8	1.2	5.8	2.9	3.1	3.4	3.9	3.6	3.4	3.5	3.3
Malta	3.3	2.7	1.9	8.2	7.2	5.5	6.9	5.6	4.5	5.6	4.9	4.1
Netherlands	2.3	2.6	-0.4	1.4	2.3	2.2	3.2	2.9	2.5	3.2	2.7	2.5
Austria	2.2	2.7	0.3	0.8	1.1	1.5	3.1	2.9	2.3	2.6	2.4	2.3
Portugal	1.9	1.4	-1.6	0.9	1.8	1.5	2.7	2.2	1.9	2.6	2.1	1.8
Slovenia	3.8	4.8	-2.0	3.0	2.3	3.1	4.9	4.2	3.5	4.7	4.0	3.3
Slovakia	2.8	7.4	1.1	2.8	3.9	3.3	3.4	4.0	4.2	3.3	3.8	4.0
Finland	3.3	3.3	-1.1	-0.6	0.0	1.9	3.3	2.8	2.5	3.3	2.7	2.4
Euro area	2.1	2.1	-0.4	1.3	2.1	1.8	2.4	2.3	2.0	2.2	2.1	1.9
Bulgaria	2.5	6.8	0.1	1.3	3.6	3.9	3.8	3.7	3.5	3.9	3.8	3.6
Czech Republic	2.8	5.3	-0.4	2.7	5.3	2.6	4.5	3.2	2.9	4.3	3.0	2.9
Denmark	1.7	1.9	-0.1	1.6	1.6	2.0	2.1	2.0	1.9	2.3	2.0	1.9
Croatia	3.4	4.0	-2.4	-0.1	2.3	3.2	3.2	2.8	2.7	3.2	2.8	2.7
Hungary	3.9	2.9	-0.8	4.2	3.4	2.2	3.8	3.7	3.1	3.7	3.6	3.1
Poland	3.2	5.2	2.9	3.3	3.8	2.9	4.6	4.2	3.6	4.2	3.8	3.4
Romania	3.6	7.1	-0.4	3.1	4.0	4.8	6.7	4.5	4.0	5.7	4.4	4.1
Sweden	3.0	2.9	0.8	2.6	4.5	3.2	2.7	2.7	2.0	3.2	2.7	2.2
EU27	2.2	2.3	-0.3	1.5	2.3	2.0	2.6	2.5	2.1	2.4	2.2	2.0
United Kingdom	3.0	2.0	0.5	3.1	2.3	1.9	1.8	1.4	1.1	1.5	1.3	1.1
EU28	2.3	2.3	-0.2	1.8	2.3	2.0	2.4	2.3	2.0	2.3	2.1	1.9

Table 2: Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter, 2017-19)

30.01.2018

	2017/1	2017/2	2017/3	2017/4	2018/1	2018/2	2018/3	2018/4	2019/1	2019/2	2019/3	2019/4
Belgium	0.7	0.5	0.2	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Germany	0.9	0.6	0.8	0.5	0.7	0.6	0.5	0.5	0.5	0.5	0.5	0.5
Estonia	1.0	1.3	0.3	1.0	0.9	0.8	0.8	0.8	0.7	0.7	0.7	0.7
Ireland	-3.4	2.7	4.2	:	:	:	:	:	:	:	:	:
Greece	0.7	0.8	0.3	:	:	:	:	:	:	:	:	:
Spain	0.8	0.9	0.8	0.7	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5
France	0.6	0.6	0.5	0.6	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.5
Italy	0.5	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Cyprus	0.7	1.0	0.9	:	:	:	:	:	:	:	:	:
Latvia	1.7	1.4	1.5	0.2	1.1	0.8	0.8	0.7	0.7	0.7	0.7	0.7
Lithuania	1.1	0.6	0.4	1.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Luxembourg	-0.5	0.7	1.7	:	:	:	:	:	:	:	:	:
Malta	1.0	2.1	1.9	:	:	:	:	:	:	:	:	:
Netherlands	0.6	1.5	0.4	0.7	0.7	0.7	0.6	0.6	0.6	0.6	0.5	0.5
Austria	1.3	0.8	0.8	0.7	0.7	0.7	0.7	0.6	0.6	0.5	0.5	0.5
Portugal	0.9	0.3	0.5	0.6	0.6	0.5	0.5	0.5	0.5	0.4	0.4	0.4
Slovenia	1.2	1.2	1.0	1.0	1.1	1.1	1.0	0.9	0.8	0.8	0.8	0.8
Slovakia	0.8	0.9	0.8	1.2	1.0	1.1	1.0	1.1	1.1	1.1	1.0	1.0
Finland	1.2	0.8	0.4	1.1	0.7	0.7	0.5	0.6	0.6	0.6	0.6	0.6
Euro area	0.6	0.7	0.7	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Bulgaria	0.9	1.0	0.9	1.0	0.8	0.9	0.8	0.9	0.8	0.9	0.8	0.9
Czech Republic	1.5	2.5	0.5	0.7	0.7	0.6	0.7	0.8	0.8	0.7	0.6	0.6
Denmark	0.7	0.6	-0.5	1.4	0.3	0.5	0.5	0.5	0.5	0.5	0.4	0.4
Croatia	0.8	0.9	0.9	0.2	0.8	0.9	0.7	0.6	0.6	0.6	0.6	0.6
Hungary	1.3	0.9	0.9	0.8	1.0	1.0	0.9	0.7	0.7	0.7	0.7	0.6
Poland	1.1	0.9	1.2	1.2	0.9	0.8	0.7	0.9	0.9	0.8	0.8	0.8
Romania	2.0	2.0	2.6	-0.5	1.2	1.2	1.2	1.1	1.0	0.9	0.8	0.8
Sweden	0.5	1.2	0.8	0.7	0.6	0.6	0.5	0.5	0.5	0.4	0.4	0.4
EU27	0.7	0.8	0.7	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5
United Kingdom	0.3	0.3	0.4	0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.3
EU28	0.6	0.7	0.7	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5

Table 3: Harmonised index of consumer prices (national index if not available), (percentage change on preceding year, 1999-2019) 30.01.2018

	5-year averages						Winter 2018 forecast			Autumn 2017 forecast		
	1999-03	2004-08	2009-13	2014	2015	2016	2017	2018	2019	2017	2018	2019
Belgium	1.9	2.6	1.9	0.5	0.6	1.8	2.2	1.5	1.6	2.2	1.4	1.6
Germany	1.3	2.1	1.5	0.8	0.1	0.4	1.7	1.6	1.6	1.7	1.5	1.6
Estonia	3.5	5.8	3.1	0.5	0.1	0.8	3.7	3.1	2.6	3.7	3.0	2.7
Ireland	4.1	2.6	0.1	0.3	0.0	-0.2	0.3	0.9	1.1	0.3	0.8	1.2
Greece	3.2	3.4	1.9	-1.4	-1.1	0.0	1.1	0.8	1.3	1.2	0.8	1.3
Spain	3.0	3.4	1.8	-0.2	-0.6	-0.3	2.0	1.6	1.5	2.0	1.4	1.5
France	1.7	2.2	1.5	0.6	0.1	0.3	1.2	1.5	1.5	1.1	1.2	1.5
Italy	2.4	2.4	2.0	0.2	0.1	-0.1	1.3	1.3	1.5	1.4	1.2	1.5
Cyprus	2.9	2.5	1.9	-0.3	-1.5	-1.2	0.7	1.2	1.3	1.0	1.1	1.4
Latvia	2.4	9.0	1.7	0.7	0.2	0.1	2.9	3.1	2.9	2.9	2.8	2.9
Lithuania	0.7	4.9	2.8	0.2	-0.7	0.7	3.7	2.9	2.5	3.8	2.9	2.5
Luxembourg	2.4	3.3	2.2	0.7	0.1	0.0	2.1	1.9	1.6	2.1	1.7	1.9
Malta	2.5	2.6	2.1	0.8	1.2	0.9	1.3	1.5	1.8	1.3	1.5	1.8
Netherlands	3.1	1.7	2.0	0.3	0.2	0.1	1.3	1.6	2.3	1.3	1.5	2.2
Austria	1.6	2.2	2.1	1.5	0.8	1.0	2.2	2.1	1.9	2.0	1.6	1.7
Portugal	3.3	2.6	1.5	-0.2	0.5	0.6	1.6	1.6	1.5	1.5	1.4	1.5
Slovenia	7.4	3.6	1.9	0.4	-0.8	-0.2	1.6	1.8	2.0	1.6	1.5	1.8
Slovakia	8.3	4.1	2.2	-0.1	-0.3	-0.5	1.4	2.2	2.0	1.3	1.7	2.0
Finland	2.0	1.5	2.4	1.2	-0.2	0.4	0.8	1.4	1.6	0.9	1.3	1.7
Euro area	2.0	2.4	1.7	0.4	0.0	0.2	1.5	1.5	1.6	1.5	1.4	1.6
Bulgaria	5.7	7.8	2.3	-1.6	-1.1	-1.3	1.2	1.4	1.5	1.0	1.5	1.6
Czech Republic	2.3	3.1	1.8	0.4	0.3	0.6	2.4	2.4	2.0	2.4	2.1	2.0
Denmark	2.3	2.0	1.8	0.4	0.2	0.0	1.1	1.4	1.6	1.0	1.4	1.7
Croatia	3.5	3.4	2.2	0.2	-0.3	-0.6	1.3	1.6	1.7	1.3	1.5	1.6
Hungary	7.8	5.7	4.0	0.0	0.1	0.4	2.4	2.8	2.9	2.3	2.6	3.0
Poland	5.0	2.8	3.0	0.1	-0.7	-0.2	1.6	2.1	2.6	1.6	2.1	2.8
Romania	32.7	8.1	4.8	1.4	-0.4	-1.1	1.1	4.1	3.0	1.0	2.9	3.0
Sweden	1.8	1.7	1.3	0.2	0.7	1.1	1.9	1.8	1.7	1.8	1.6	1.7
EU27	3.1	2.7	1.9	0.4	0.0	0.2	1.6	1.7	1.7	1.6	1.5	1.8
United Kingdom	1.2	2.3	3.1	1.5	0.0	0.7	2.7	2.7	2.0	2.7	2.6	2.1
EU28	2.9	2.6	2.1	0.5	0.0	0.3	1.7	1.9	1.8	1.7	1.7	1.8

Table 4: Harmonised index of consumer prices (national index if not available), (percentage change on preceding year, 2017-19) 30.01.2018

	2017/1	2017/2	2017/3	2017/4	2018/1	2018/2	2018/3	2018/4	2019/1	2019/2	2019/3	2019/4
Belgium	3.0	2.0	1.9	2.0	1.7	1.5	1.5	1.5	1.6	1.6	1.5	1.5
Germany	1.9	1.6	1.7	1.6	1.6	1.7	1.7	1.5	1.5	1.5	1.6	1.6
Estonia	3.1	3.4	4.0	4.1	3.4	3.2	2.7	3.0	2.7	2.7	2.6	2.6
Ireland	0.4	0.0	0.1	0.5	0.9	1.0	1.0	0.8	0.9	1.1	1.1	1.1
Greece	1.5	1.3	0.8	0.8	0.4	0.8	0.9	1.1	1.1	1.1	1.1	1.9
Spain	2.7	2.1	1.8	1.6	1.5	1.7	1.8	1.5	1.5	1.5	1.5	1.5
France	1.5	1.0	0.9	1.2	1.2	1.6	1.7	1.6	1.5	1.5	1.5	1.6
Italy	1.3	1.6	1.3	1.1	0.8	1.2	1.4	1.5	1.5	1.4	1.5	1.5
Cyprus	1.2	1.3	0.2	0.1	0.7	1.7	1.1	1.2	0.8	1.3	1.4	1.5
Latvia	3.1	3.0	2.9	2.5	3.8	3.2	2.8	2.6	2.5	2.7	3.2	3.1
Lithuania	3.0	3.4	4.5	4.1	4.0	3.1	2.7	2.0	2.5	2.6	2.7	2.3
Luxembourg	2.6	2.0	2.0	1.8	1.7	1.9	2.0	1.8	1.6	1.5	1.5	1.7
Malta	1.3	1.1	1.2	1.4	1.4	1.6	1.6	1.6	1.7	1.7	1.8	1.9
Netherlands	1.3	1.0	1.5	1.4	1.4	2.0	1.5	1.6	2.3	2.3	2.3	2.3
Austria	2.2	2.2	2.2	2.4	2.1	2.2	2.3	1.9	1.8	1.8	1.9	2.0
Portugal	1.4	1.7	1.3	1.8	1.6	1.6	1.7	1.5	1.5	1.6	1.5	1.5
Slovenia	2.0	1.4	1.3	1.5	1.7	1.8	2.0	1.8	1.7	1.9	2.0	2.3
Slovakia	1.0	1.0	1.6	2.0	2.0	2.4	2.4	2.2	2.1	2.0	2.0	2.0
Finland	1.1	0.9	0.7	0.6	1.4	1.4	1.4	1.4	1.5	1.6	1.7	1.7
Euro area	1.8	1.5	1.4	1.4	1.4	1.6	1.7	1.5	1.5	1.5	1.6	1.6
Bulgaria	0.8	1.4	0.9	1.7	1.7	1.4	1.6	1.0	1.5	1.5	1.5	1.6
Czech Republic	2.5	2.3	2.4	2.5	2.0	2.3	2.7	2.8	2.4	2.1	1.8	1.6
Denmark	0.8	0.7	1.5	1.2	1.1	1.4	1.6	1.5	1.5	1.6	1.6	1.6
Croatia	1.1	1.1	1.4	1.5	1.6	1.7	1.7	1.6	1.8	1.8	1.7	1.6
Hungary	2.6	2.1	2.5	2.3	2.6	3.0	2.9	2.5	2.5	2.9	3.1	3.3
Poland	1.7	1.5	1.5	1.8	1.6	2.1	2.5	2.2	2.3	2.5	2.7	2.8
Romania	0.4	0.6	1.0	2.4	4.3	4.3	4.1	3.6	3.3	2.9	2.8	2.7
Sweden	1.6	1.8	2.2	1.8	1.7	1.8	1.9	1.7	1.6	1.7	1.7	1.8
EU27	1.7	1.5	1.5	1.5	1.4	1.7	1.8	1.6	1.6	1.6	1.7	1.7
United Kingdom	2.2	2.8	2.8	3.0	2.7	2.8	2.7	2.5	2.2	2.0	1.9	1.8
EU28	1.8	1.7	1.7	1.7	1.7	1.9	1.9	1.8	1.7	1.7	1.7	1.7

Box 1: Some technical elements behind the forecast

The European Commission presents its first new issue of what will be twice-yearly interim forecasts, resuming its annual schedule of two-fully fledged forecasts and two much shorter interim forecasts as done until the height of the sovereign debt crisis. The interim forecasts provide an update of GDP and inflation developments for all EU Member States. They will be published in February and July, providing an update of its comprehensive spring and autumn economic forecasts. This interim forecast updates the outlook of the autumn 2017 economic forecast of 9 November 2017.

Given the ongoing negotiations on the terms of the UK withdrawal from the EU, projections for 2019 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 the outcome of the talks underway in the context of the Article 50 process.

The cut-off date for taking new information into account in this European Economic Forecast was 30 January 2018.

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). 2018 and 2019 are forecast years. 2017 GDP data are also forecast, except for DE and FR.

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 15 and 26 January) 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 1.23 in 2018 and 2019. The average JPY/EUR is 135.51 in 2018 and 135.52 in 2019.

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 2018 and 0.0 in 2019 in the euro area. Long-term euro area interest rates are assumed to be 0.7% in 2018 and 0.9% in 2019.

Commodity price assumptions are also based on market conditions. According to futures markets, prices for Brent oil are projected to be on average 68.3 USD/bbl in 2018, and 64.2 USD/bbl in 2019. This would correspond to an oil price of 55.6 EUR/bbl in 2018, and 52.3 EUR/bbl in 2019.

Global demand in 2018 is revised upwards, following the improved outlook for US growth and a rebound in world trade. After having reached 3.8% in 2017, global GDP growth, excluding the EU, is now forecast to increase further to 4.1% in both 2018 and 2019, about 0.1 pps. more than expected in the autumn forecast. World trade growth has also been revised upwards compared to the autumn. It is now set to pick up in 2018 before moderating slightly in 2019. Import volumes of goods and services (excluding the EU) are estimated to grow by 4.7% in 2018 and 4.5% in 2019 (up from 4.1% in the autumn forecast).

Calendar effects on GDP growth

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. However, the working-day effect in the EU and the euro area is estimated to be limited over the forecast horizon, implying that adjusted and unadjusted annual growth rates differ only marginally (by up to ± 0.1 pps.).

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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