EUROFRAME

European Forecasting Research Association for the Macro-Economy

Economic Assessment of the Euro Area

Winter 2019/2020

February 2020

Ten independent Research Institutes throughout Europe have founded the EUROFRAME network, an initiative for improved forecasting and macroeconomic analysis in the European Union.

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European Forecasting Research Association for the Macro-Economy

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Economic Assessment of the Euro Area: Winter 2019/2020

This EUROFRAME Report presents an assessment of the economic outlook for 2020 and 2021 focused on the euro area based on a synopsis of the forecasts of EUROFRAME institutes. Perspectives for UK and CEEs countries are described in Boxes A and B respectively.

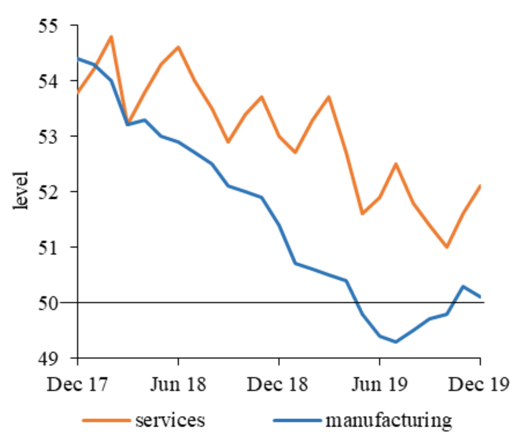
In the Focus section, we discuss a special topic, based on work done in the EUROFRAME institutes. This time, against the backdrop of the weakening world trade growth, we discuss the evolution of industrial production in Europe, highlighting countries peculiarities.

The international outlook: moving forward slowly

Confidence slowly improving. Amid reduced trade tensions and expansionary monetary policies, confidence is slowly improving worldwide (Chart 1). According to CPB World Trade Monitor, in October and November on average, global trade annual growth stopped deteriorating. The first deal in the US-China trade dispute (phase-one) is contributing to halt the deterioration of firms' expectations, while private consumption remains resilient thanks to favourable conditions in the labour markets and low inflation. All this may facilitate the resumption of investments but it is likely it will not be enough for a strong global recovery.

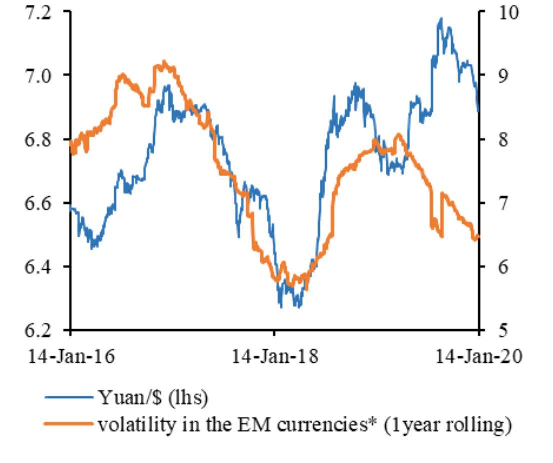
Less uncertainty thanks to the US-China phase-one deal. The US-China phase-one deal reduces uncertainty but does not withdraw it. Although the deal prevents further escalations of protectionism and retaliation measures for the time being, some important issues, like the diffusion of advanced technologies (5G), have not been addressed yet. In addition, US are continuing to use tariffs as instrument in bilateral economic disputes.

Chart 1 - Purchasing Manager Indices for the Global Economy



Source: JP Morgan

Chart 2 - Yuan/$ exchange rate and Volatility Index*



Source: Refinitiv and JP Morgan
* EM FX Index standard deviation on a rolling 12m window

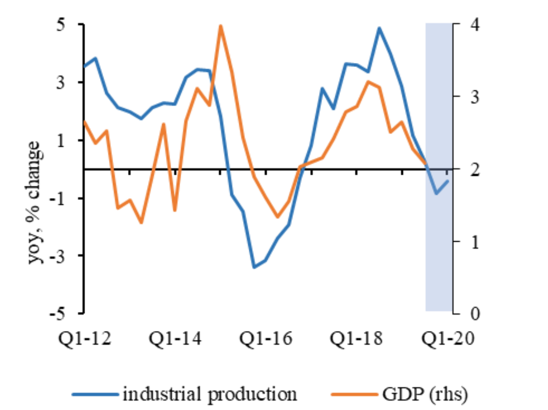
This is exemplified by the threat of higher US tariffs on some specific goods imported from Europe if European countries increase taxation on the big American tech companies.

The relaxation of monetary conditions put in place in the second half of 2019 by several central banks helped to improve confidence, as well. This includes the new round of Quantitative Easing by the European Central Bank started in November 2019 and the ongoing exceptional intervention of the US Federal Reserve in the liquidity market, after the cumulative reduction of the Federal Fund target rate with 75 basis points in 2019.

China expected to decelerate further. The US-China deal is improving confidence in China and reducing volatility in the international financial markets. This will not avoid a further deceleration of the Chinese growth[1], in line with the government target, but it will contribute to restore the pivotal role of China in the global economy, avert the risk of a strong depreciation of the Renminbi and possibly reduce the volatility in the international currency markets (Chart 2). In December 2019 Chinese imports of goods grew by 16.3 per cent yoy in dollar terms, whereas on the average January-November 2019 the annual growth rate stood at -4.5 per cent. The strengthening of the Renminbi and the less volatile international currency markets will also contribute to ease financial tensions in the emerging countries with high debt in foreign currencies.

Lower growth in US. In the US, GDP is expected to decelerate in the wake of the difficulties in manufacturing industry that are expected to persist in the first quarter of 2020 (Chart 3), but the risk of recession has been reducing. Labour market conditions are still very sound and the Fed remains strongly committed to the good functioning of monetary policy.

Chart 3 - US real GDP and industrial production



Source: Bureau of Economic Analysis and Prometeia's forecasts on Federal Reserve

Moderate global growth in 2020 and more pronounced downward risks. Overall, the international environment is slowly improving but the expected deceleration of growth in US and China matched with the fragilities of the global economy anticipate a moderate global growth in 2020. Most recently, new uncertainties emerged with the spreading of the new coronavirus in and beyond China. These new uncertainties fuel the chances of jeopardizing recent signs of stabilization in

[1] In addition, at the time of writing, the coronavirus is threatening to decrease the economic growth figure for 2020.

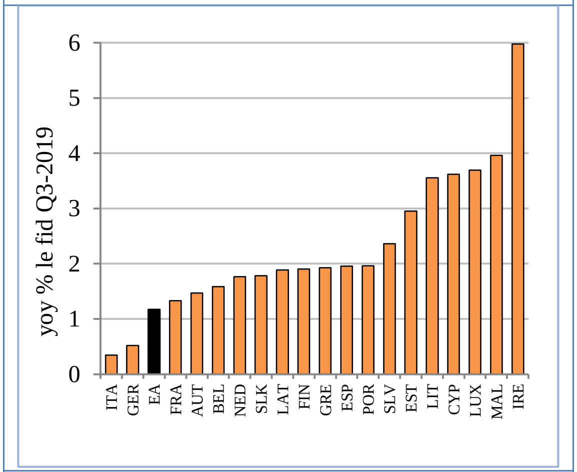
economic indicators globally. The drastic measures implemented in China in order to contain the epidemic will have a significant negative impact on output in China in the first quarter, and there is a risk of a more sustained reduction of growth, including negative repercussions on world trade, resulting from this event. These risks are reflected in a drop in commodity prices and a downward correction in stock markets worldwide.

The Euro Area Outlook: Modest growth amid continued policy uncertainties

Euro area GDP growth stabilised at a low level in 2019. Growth in the euro area had slowed down markedly in the course of 2018 mainly reflecting diminishing impulses from external demand. The deceleration of underlying GDP growth continued into 2019 and centred on activity in the manufacturing sector (see focus section below). Annual GDP growth has declined to only 1 per cent from 1.9 per cent in 2018, according to the average of EUROSTAT. This outcome is notably below the expectations that prevailed at the beginning of last year, including those presented in last year's EUROFRAME Economic Assessment of the Euro Area, which stood at 1.6 per cent. The good news is, however, that GDP growth on a sequential basis seems to have stabilised in the course of 2019, albeit at a low level of around 0.2 per cent per quarter, and leading indicators (including the [Euro Growth Indicator]() calculated by EUROFRAME on a monthly basis) suggest a gradual strengthening of economic activity at the beginning of 2020.

Moderation of growth is broad-based, but only few countries are flirting with recession. Year-on-year growth rates have come down to below 2 per cent in most countries of the euro area with only a few smaller economies continuing to grow at significantly higher rates (Chart 4). At the same time, however, growth remained generally firmly in positive territory with the exceptions of Italy, where GDP is more or less stagnating since early 2018, and Germany, which only narrowly escaped a technical recession in the course of 2019.

Chart 4 - GDP growth rate in the euro area



Source: Eurostat

External demand remained subdued, while domestic demand showed some resilience. Exports lost further momentum in 2019 reflecting slower world economic growth, increased trade tensions and persistent uncertainty around Brexit. Meanwhile domestic demand growth even accelerated somewhat from 1.6 per cent to 2 per cent, although much of this improvement is explained by huge fluctuations in Irish investment figures due to activities in the multinational sector. Underlying investment growth slowed down moderately, whereas private consumption continued to grow at around 1 ¼ per cent and government consumption picked up somewhat to about 1 ½ per cent, from 1.1 per cent in 2018.

Macroeconomic policy is supportive. In order to support growth in the context of an inflation rate that remains persistently below target, the ECB has reverted towards an extremely accommodative stance with the introduction of a number of expansive measures, including a further reduction of the deposit rate to –0.5 per cent and the resumption of net asset purchases from November 2019 onwards. With policy rates expected to remain extremely low for an extended period of time, financing conditions are benign. On aggregate, fiscal policy has also been slightly expansive in 2019 and is expected to remain so in 2020, albeit moderately as fiscal space is still limited in many euro area countries given current fiscal rules.

Low inflation and robust labour markets underpin domestic demand growth. The downturn in manufacturing has so far had limited impact on the overall labour market. Employment in the euro area has remained on an upward trajectory and unemployment has continued to decline throughout 2019 to 7.5 per cent (November), although the downward momentum has decreased. Wages continued to grow at around 2 per cent (compensation of employees) and with consumer price inflation decreasing mainly due to a lower contribution of energy prices, real wage growth even increased. Robust labour markets and rising wage income are expected to support consumer expenditure also in 2020.

Downside risks still abound. Many of the uncertainties that dampened economic growth in 2019 remain in place and others have been emerging. Uncertainties around Brexit have decreased only to the extent that the exit of the UK from the European Union has finally taken place on 31 January 2020, the consequences for economic activity continue to be largely unclear with a hard Brexit at the end of this year still being an option. While the risk of a further escalation of the trade conflict between the US and China has declined for the time being with the agreement on a partial trade deal, the basic issues have not been resolved and the tariffs imposed remain in place. At the same time, trade issues between the US and the European Union seem to have moved into the focus and threaten to increase uncertainties for exporters in the euro area further and weigh on investment. In the short-term, the coronavirus outbreak – a deadly respiratory disease – could have significant impact on economic activity in and beyond China.

In summary. Overall, EUROFRAME institutes expect that growth in the euro area has bottomed, but growth is expected to accelerate only very gradually in the coming two years. On average, GDP is expected to rise by 1.1 per cent in 2020 and 1.3 per cent in 2021. Despite sluggish growth labour market conditions will improve further albeit at a diminished pace. The unemployment rate is expected to fall to 7.2 per cent in 2021, below the previous lows recorded in 2008. Consumer price inflation is expected to pick up only slightly to 1.4 per cent, from 1.2 per cent in 2019 and 2020, respectively.

Table 1 - Euro Area Forecasts - EUROFRAME Institutes' average

GDP			CPI Inflation*			Unemployment Rate**		
2019	2020	2021	2019	2020	2021	2019	2020	2021
1.2	1.1	1.3	1.2	1.2	1.4	7.5	7.3	7.2

* HICP
** Eurostat definition

Table 2 - Euro Area Forecasts

Institute	GDP			CPI Inflation*			Unemployment Rate**			Date of forecast
	2019	2020	2021	2019	2020	2021	2019	2020	2021	
ETLA	1.2	1.0	1.3	1.2	1.2	1.5	7.5	7.5	7.5	01/2020
OFCE	1.2	1.2	1.3	1.3	1.2	1.3	7.6	7.4	7.4	10/2019
DIW	1.0	1.0	1.4	1.3	1.3	1.4	7.4	7.3	7.1	12/2019
IfW	1.2	1.2	1.5	1.2	1.2	1.3	7.6	7.2	7.0	12/2019
Prometeia	1.2	1.1	1.3	1.2	1.2	1.4	7.5	7.4	7.3	12/2019
CPB	1.1	1.1	-	1.2	1.2	-	-	-	-	12/2019
NIESR	1.1	1.3	1.4	1.3	1.3	1.7	7.6	7.3	6.8	11/2019

* HICP
** Eurostat definition

BOX A: UK prospects

The UK economy is estimated to have grown by 1.4 per cent in 2019. This is lower than what was expected a year ago, but unchanged on 2018. This weakness can be explained by prolonged economic and political uncertainty around Brexit and subdued global demand.

With three Brexit deadlines passing in the spring and autumn without a formal exit taking place, 2019 economic growth was very volatile. Brexit preparations and stockbuilding boosted economic activity in the first quarter of last year, while reductions in stocks contributed to a negative quarter-on-quarter GDP print in the second quarter. At an estimated 0.4 per cent and 0.0 per cent, respectively, growth in the final two quarters was subdued. Evidence suggests that Brexit uncertainty and the prospect of higher trade barriers in the future have been holding back investment and productivity growth. Business investment is estimated to have contracted by 1.4 per cent relative to 2018 while productivity growth of around 0.3 will have been weaker than in the previous four years, when it never reached more than 1 per cent per annum.

The economic weakness is due to contractions in the production and construction sectors and a softening of service sector output growth. The manufacturing sector suffered from weaker global demand, trade tensions and problems in the auto sector. For instance, car production, 80 per cent of which is exports, fell by around 15 per cent in the year to November 2019, compared to the previous year.[2] With the exception of certain professional services that saw a stronger expansion, service sector weakness can be linked to Brexit uncertainty and explained by the fact that most forms of Brexit involve an exit from the European single market and therefore higher barriers to services trade.

Employment growth has stabilised as reductions in manufacturing employment has been offset by continued hiring in private service sectors and a pick-up in public sector employment growth.

While the December 2019 General Election lifted some of the political uncertainty, the form of future UK-EU trade remains unclear and a no-deal exit at the end of 2020 is still a possibility. While a reduction in uncertainty may encourage some of the investment that was previously held back to return, the prospect of future trade frictions is expected to prevent a meaningful pick-up in economic activity. With only little slack in the economy, an expected increase in government spending will only make a small contribution to growth. As a result, NIESR forecasts GDP growth of 1-1 ½ per cent in 2020, similar to the last two years.

BOX B: CEECs prospects

Central and Eastern European Countries (CEECs) enjoyed rapid economic growth in 2019, with Hungary and Poland taking the lead and recording GDP yoy growth of 4.9 and 4.2 per cent respectively. Other relatively robust economies included Lithuania and Bulgaria while on the other side of the spectrum were the Czech Republic and Slovakia, displaying weaker economic dynamics of 2.5 and 2.4 per cent respectively. Private consumption appeared to be an important driver behind the observed GDP growth, again with Hungary and Poland as the top performers and the Czech Republic scoring the worst. Hungary also happened to enjoy great private investment dynamic in 2019, reaching 15.9 per cent yoy and outdistancing other economies in the region. Private investment was also strong in Poland (+7.1 per cent yoy) and Lithuania (+7.9 per cent). Despite different consumption and investment patterns, CPI was at moderate levels across the CEECs, with 3.3 per cent yoy (Hungary) and 2.2 per cent yoy (Poland) being the highest and lowest recorded values in 2018; there is little proof that price dynamics should accelerate in the near future. Against this backdrop, the latest EC readings of unemployment in the region indicated that it was the lowest in the Czech Republic (at 1.9 per cent seasonally adjusted in November 2019 and nominal wages' growth at 7.2 per cent yoy), with slightly higher rates recorded in Poland (3.2 per cent) and Hungary (3.5 per cent); in Lithuania this rate reached 6.4 per cent and was the highest in CEE. In light of the economic slowdown in the Eurozone, local political tensions and prevailing global uncertainty regarding trade, CEECs' economic

[2] SMMT Manufacturing Data, https://www.smmt.co.uk/vehicle-data/manufacturing/.

growth is expected to decrease slightly in 2020, down to 3.4 per cent yoy in Poland and as low as 2.1 per cent in the Czech Republic. The only economy not to record a marked plunge could be Slovakia, for whom a growth of 2.4 per cent is expected (no change relative to 2019). As for specific factors, private consumption is expected to decrease slightly, as is private investment, with Hungary (-11.5 pp), Poland (-3.7pp), and Lithuania (-3.2 pp) likely experiencing the most pronounced slowdown in this area.

Table 3 - Individual Country Forecasts

Country	GDP growth (%)[a]			CPI Inflation (HICP) (%)			Unemployment Rate (Eurostat definition, %)			Date of forecast
	2019	2020	2021	2019	2020	2021	2019	2020	2021	
Austria (WIFO)**	1.7	1.2	1.4	1.4	1.5	1.6	4.6	4.7	4.7	12/2019
Finland (ETLA)	1.4	0.9	1.1	1	1.1	1.4	6.5	6.3	6.1	01/2020
France (OFCE)	1.3	1.3	1.2	1.1	1.2	1.3	8.5	8.2	8.1	10/2019
Germany (DIW)	0.5	0.8	1.4	1.4	1.5	1.6	3.1	3.2	3.0	12/2019
Germany (IfW)	0.6	0.7	1.5	1.3	1.3	1.5	3.1	3.0	2.9	12/2019
Italy (Prometeia)	0.2	0.5	0.7	0.6	0.9	1.2	10	9.7	9.6	12/2019
Ireland (ESRI)	5.8	3.3		1.0	1.2		5.0	4.6		12/2019
Netherlands (CPB)	1.7	1.3		2.7	1.4		3.4	3.6		12/2019
Poland (Case)	4.3	3.3	3.1	2.3	2.9	2.8	3.1	2.9	2.7	12/2019
United Kingdom (NIESR)	1.4	1.4	1.5	1.9	2.0	2.0	3.9	4.0	3.9	11/2019

[a] working day adjusted
** not working day adjusted

Focus: Industry in recession but services still resilient

Overview

Against the backdrop of increasing trade tensions, the global economy has been decelerating and international trade of goods almost stagnated in 2019, negatively weighting on the tradable sectors. European countries heavily suffered the slowdown: since the beginning of 2018, the euro area industrial production in the manufacturing sector decreased by 3.5 per cent (Chart 5). However, the developments in the home countries of the EUROFRAME member institutes (which represent close to 80 per cent of the total euro area economy) indicate heterogeneous performances depending on several factors, from the relevance of the manufacturing and automotive sectors (Chart 6) to the different trade specialization.

The most hit country is Germany where the effects of the restructuring process in the automotive sector added to the slowdown of the global economy. German's industrial production fell by 7.3 per cent since January 2018 whereas, on the other hand, industrial production in Poland grew by 8.9 per cent.

For some of the EUROFRAME countries, the difficulties of industry have resulted in a contraction of the value added (VA) in the

Chart 5 - Industrial production, manufacturing

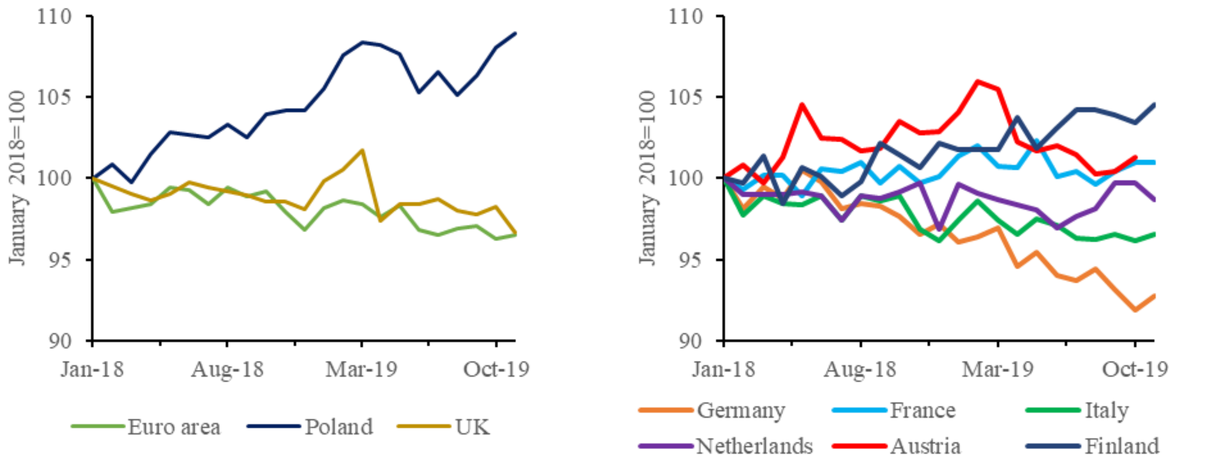


Chart 6a - Share of automotive production on manufacturing

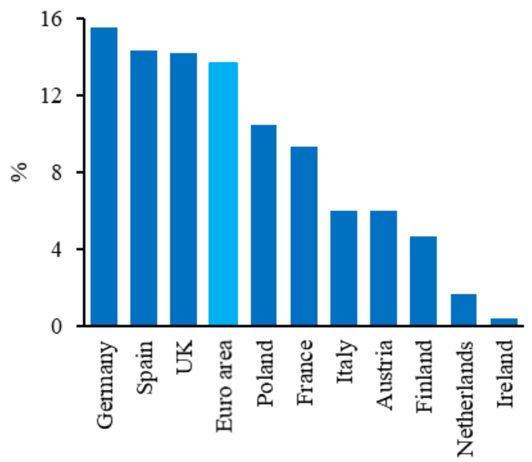
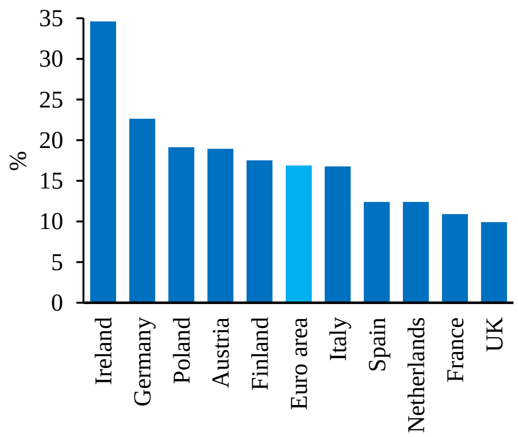


Chart 6b - Share of Manufacturing value added on GDP



Source: Prometeia calculations on Eurostat manufacturing sector, whereas the resilience of private consumption sheltered services and the construction sector (Table 4).

The value added development confirmed the negative shock especially for those countries more exposed in the manufacturing and automotive sector (Germany) and more open to global trade (Germany and Italy). The quarterly profile evidences that the prolonged deterioration of the external environment and the persistent difficulties in Germany have begun to hit countries that in 2018 and the first part of 2019 were less involved in the deceleration of industry. It is the case in Austria and France, where the manufacturing sector VA contracted qoq only in the second and third quarter of 2019.

On the positive side, it is worth considering that the less strong qoq deceleration in 2019 Q3 with respect to the previous quarter suggests that some improvements could be on the way. The reduced global uncertainty linked to the trade truce between US and China and the progress in the German automotive sector could help to improve further confidence.

Table 4 – Value Added

Chain linked volumes	% changes qoq				% changes yoy				% change
	IV-18	I-19	II-19	III-19	IV-18	I-19	II-19	III-19	III-19/IV-17
Manufacturing									
Austria	0.3	1.6	-0.9	-0.8	2.7	3.2	1.1	0.2	2.6
Finland	-0.2	3.9	0.4	2.7	-2.8	0.3	3.2	6.9	4.1
France	0.2	0.3	-0.3	-0.6	-0.9	0.9	0.5	-0.3	-1.4
Germany	-0.5	-1.1	-1.3	-1.1	-1.3	-2.2	-3.7	-3.9	-4.7
Ireland	-2.8	1.1	5.8	0.4	1.8	3.4	4.5	4.4	9.3
Italy	-0.4	0.3	-0.3	-0.2	-1.1	-0.3	-0.8	-0.6	-1.3
Netherlands	-0.3	-0.1	-0.7	1.1	2.6	1.7	0.0	0.0	2.9
Euro area	-0.3	-0.1	-0.4	-0.3	-0.4	-0.3	-1.1	-1.1	-1.1
Poland	1.7	0.9	0.5	2.0	6.6	5.8	4.2	5.2	10.2
United Kingdom	-0.9	2.4	-2.7	0.1	-1.8	1.0	-1.3	-1.2	-2.1
Construction									
Austria	1.1	0.2	0.5	-0.5	4.2	3.9	3.2	1.3	4.4
Finland	0.2	0.3	-0.6	-0.2	2.6	2.1	0.1	-0.3	2.1
France	0.3	0.5	0.7	0.5	-0.5	0.3	1.4	2.1	1.3
Germany	2.2	1.1	-0.8	2.0	5.4	5.3	3.5	4.5	7.8
Ireland	-2.4	2.6	-1.6	1.3	2.6	6.4	0.7	-0.3	4.9
Italy	0.2	3.4	-1.1	0.1	1.6	6.0	3.2	2.5	3.9
Netherlands	2.4	2.9	-1.4	1.1	6.3	10.5	3.5	5.0	9.1
Euro area	1.3	1.5	-0.1	0.6	3.5	4.8	3.4	3.2	5.5
Poland	1.8	1.4	0.2	0.7	11.9	6.5	4.7	4.1	14.5
United Kingdom	-0.1	1.8	-1.0	1.2	-0.3	3.4	1.6	1.8	1.5
Services									
Austria	0.8	0.4	0.4	0.5	1.8	1.5	1.8	2.1	3.1
Finland	-0.1	0.4	1.1	0.3	0.9	1.2	2.0	1.6	2.7
France	0.5	0.2	0.4	0.4	1.7	1.5	1.6	1.6	2.8
Germany	0.4	0.9	0.1	0.2	0.9	1.8	1.6	1.6	2.2
Ireland	1.0	2.2	2.1	1.9	6.7	9.4	8.8	7.4	13.5
Italy	0.3	-0.2	0.3	0.1	0.3	-0.3	0.2	0.5	0.5
Netherlands	0.7	0.4	0.6	0.5	2.4	1.8	1.8	2.1	3.9
Euro area	0.5	0.5	0.4	0.3	1.6	1.7	1.7	1.7	2.8
Poland	0.9	1.1	1.3	0.8	4.7	4.4	4.8	4.1	8.1
United Kingdom	0.4	0.4	0.1	0.4	2.0	2.2	1.6	1.4	3.0

Source: Eurostat

Country Details

Austria

Economic momentum is slowing in Austria, but the underlying trend remains positive. After a GDP growth of 1.7 percent in 2019, economic activity is projected to increase by 1.2 percent in 2020 and 1.4 percent in 2021. Following the cyclical boom, GDP growth dynamics have weakened markedly since spring 2018, achieving quarter-on-quarter growth rates of 0.1% in the second and third quarter 2019. Against the backdrop of the international economic slowdown and the weaker demand from Austria's main trading partners, foreign trade lost momentum, subsequently weighing on industrial production. There are also signs of a slowdown in investment by domestic companies, while private households' consumption demand – favoured by gains in disposable income and still benign labour market conditions – is acting as stabiliser of the business cycle. The overall picture of the Austrian economy is currently characterised by a cyclical dichotomy: while the industrial sector entered a phase of weakness, services (like accommodation and food service activities, wholesale and retail trade) are still supporting economic growth. In the second and third quarter 2019 value added in manufacturing declined qoq. Contrary, the solid growth in the services sector further continued. As regards the economic outlook, the unequal development is likely to continue for some time. Recent results of the WIFO business cycle indicator point to a still widening gap in the economic assessment of Austrian companies in these two sectors. On the one hand, survey results indicate that the favourable development in the service sector is likely to persist, while on the other hand, expectations in the manufacturing sector are deteriorating notably, implicating a subdued outlook for the industrial sector. In light of this, growth prospects for overall economic activity in the coming two years are modest. Subsequently, employment growth is expected to continue, but at a slower pace. Together with the ongoing expansion of labour supply, job creation will no longer be sufficient to continue the cyclical reduction in unemployment. The unemployment rate is expected to stagnate.

Chart 7a - Austria: WIFO Business climate indicator

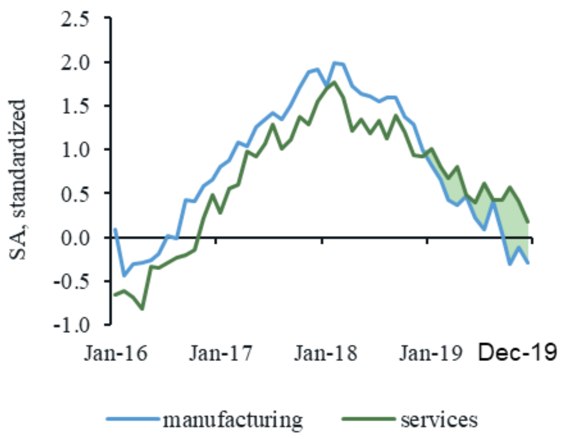
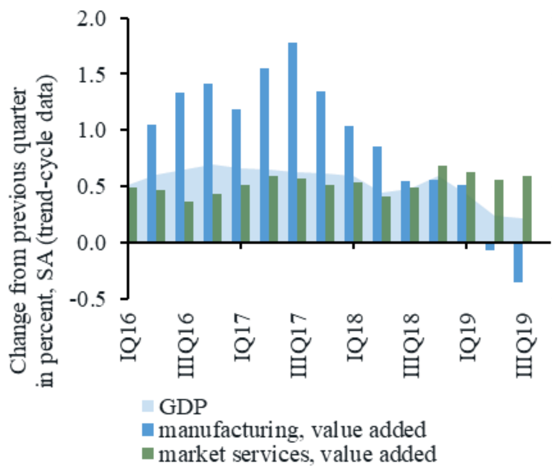


Chart 7b – Austria: Value added



Source: Eurostat

Finland

Industrial production growth has remained surprisingly robust in Finland until recently. Industrial production grew by 3.7 per cent in

November last year from November 2018. Also, between January and November 2019, industrial production grew by 2.2 per cent when compared with production between January and November 2018. However, the relatively strong growth shows signs of fading. A sentiment in the sector has been weakening since late 2018. The latest data shows that a month-to-month growth rate of industrial production was negative in September and October.

Interestingly, this years' data from industrial production has been boosted by a surge of growth in electrical and electronics industry production, something which is not easily explainable with other available information. Hence the data may be revised later. Yet another sign of a possible turning point in industrial production is the data from new orders in manufacturing sector, which has shown a year-to-year (nominal) decline in each month between August and November 2019. Also, although it started the year 2019 rather strongly, the goods export growth has slowed down significantly throughout last year, and even more so in the last three months. Nevertheless, with the better-than-expected growth numbers in industrial production, we cannot expect yet a pronounced transmission of the slowdown to the service sector. Indeed, the latest available figure from November shows that real value added in the service sector grew by roughly one and a half per cent from November 2018. However, there is a risk of a turn to worse in industrial sector activity and employment this year with its effects spilling over to the service sector too.

France

French industrial production had grown by 3.4 per cent in 2017 (yoy, at the end of the year), before decelerating sharply in 2018 (-0.6 per cent) and in in 2019 (-0.7%). At sector level, the deceleration was particularly strong for investment goods (4.1 per cent in 2017, 0.5 per cent in 2018, and -1.3 per cent in 2019), and automobile (9.8 per cent in 2017, 0.3 per cent in 2018, -1.8 per cent in 2019). In the market services sectors, output growth deceleration was more limited: from 4.4 per cent in 2017, to 2.5 per cent in 2018 and 2.2 per cent in 2019.

French output growth and short-term prospects have decelerated from early 2018 under the effect of the appreciation of the euro vis-à-vis the dollar, rising oil prices and uncertainties linked to rising protectionism, together with reduced purchasing power resulting from fiscal measures. Some limited rebound occurred in the second half of the year in the manufacturing sector, but the situation clearly improved in the services sector.

In early 2018, output prospects deteriorated in all sectors, but they still remain above the historical average. However, the Gilets jaunes contest has led to a substantial fall in prospects in the hotels, bars and restaurants sector. From the second quarter of 2018, industrial output started to fall, while it remained solid in the services sector.

In 2019, the industrial sectors were particularly affected by protectionist tensions, the uncertainties around Brexit, while services and the construction sector are positively affected by increases in households' purchasing power. Output has been boosted in the construction sector in the context of municipal elections to be held in March 2020. In the industrial sectors, tensions on supply tend to diminish while the lack of demand becomes tangible. In October 2019, industrial capacity utilisation had fallen down to its average level (83.2 against 86 in early 2018).

In early 2020, output growth in the manufacturing sector remains almost flat (-0.4 per cent yoy). Output growth in the construction is still growing (by 1 per cent yoy), but is decelerating, while market sector services continue to grow by an annual 2 per cent. Business climate indicators are close to their long-term average in the industrial sector, albeit declining since early 2018. They are somewhat higher in the services, clearly in the construction sector. In December 2019, the business climate index stood at 102 in the industrial sector (with 100 as the long-term average), but 109 in the agri-food sector, 97 in investment goods, 106 in transportation goods, 98 in the other industries. It stood at 111 in the housing sector and in technical and scientific services, 106 in road haulage, 104 in the information and communication services, 103 in the housing and administrative services. There is no clear contagion so far from the industry to the services.

We expect French GDP to continue to grow by around 1.3 per cent in 2020 and 2021, allowing for the unemployment rate to fall from 8.5 per cent in 2019 to 8.1 per cent in 2021. The consumption deflator would continue to grow by a mere 1.2 per cent per year.

Germany

The German economy slowed down to a growth rate of only 0.6 per cent in 2019. During late 2018 and in the beginning of 2019 the weakening global economy dampened German exports markedly. In the second half of the year, however, foreign demand growth was stable and only slightly below the long-term average, and is set to keep that pace. Nevertheless, industrial production contracted throughout the year, even at an increasing pace. The main driver is the slump in the car industry, where output was about ten percent lower in 2019 than in the preceding year. In contrast, turnover in the car industry was hardly contracting, by about one percent, indicating that car manufacturers empty previously build up inventories before substantially increasing their production. With inventory adjustment weighing on production rather than weak demand, the recession in the German (car) industry is bound to be temporary.

Overall, the outlook for 2020 is brightening: Surveys indicate a stabilization of industrial production, also in the car industry, possibly also related to a reduced risk perception. Employment growth came to a halt in industry. The number of persons employed in the car industry even declined by 5000 persons in the third quarter with indicators pointing at a decline of similar magnitude in the final quarter and a subdued development also in the beginning of 2020 (e.g. Ifo employment expectations of car manufacturers settled on a ten-year-low by the end of 2019). However, the upcoming recovery in industry will prevent a prolonged reduction in the industrial workforce and related sectors. The uptrend in employment in the consumption based service sectors is still intact. Economy-wide employment will increase further throughout 2020, although with previously high capacity utilization rates returning to normal levels, it will lose momentum. Overall, labour income will remain buoyant, albeit lower than in previous years. Fiscal measures such as tax reductions and increases in social transfers offset the slowing labour income, pushing growth in household disposable income above three percent. Moreover, inflation will only gradually increase, remaining low for the time being. Hence, consumption will remain a driver of the German economy and investment will pick up speed as prospects are brightening.

Ireland

The Irish economy continues to perform robustly and is forecast to grow by 5.8 per cent in 2019. This has been driven by strong growth in private consumption, investment and exports. The impressive performance of the economy is reflected in both the labour market, where the unemployment rate has fallen below 5 per cent for the first time since 2007, and in taxation receipts, which increased by nearly 7 per cent compared to 2018.

Despite the increased likelihood of a deal between the UK and the EU, Brexit remains the most significant threat to the Irish economy. Negotiations between both sides are likely to be drawn out for the foreseeable future, increasing uncertainty for consumers and investors alike. More generally, the expected slowdown in the growth of key trading partners is likely to have a significant negative impact on Irish exports going forward.

Headwinds in the domestic economy are most notable in the housing market where, despite increases in supply in recent years, the number of residential properties remains below the structural level of demand in the market. This has put significant upward pressure on house prices and rents. The nature of corporation tax receipts in Ireland, which are estimated to have a significant windfall component, also poses a threat to the Irish economy. Were these windfall revenues to evaporate the exchequer would face a sharp drop in taxation receipts which would have a significant negative impact on the countries fiscal position.

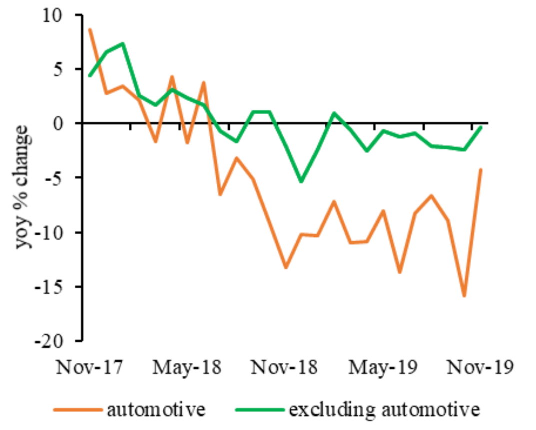
The general government balance is forecast to fall into deficit in 2020. However, this is based on contingency expenditure plans put in place in the most recent government budget which would only come into effect in the event of a No-Deal Brexit. In the now likely event that a No-Deal Brexit is avoided we may well see a budget surplus in 2020.

Italy

The Italian economy has not yet recovered its pre-crisis levels (4 per cent less than in 2007). This situation is the result of a diverse dynamic of branches of activity: while the service sector in 2019 was more than 3 per cent higher than pre-crisis levels, the manufacturing industry recorded only a modest recovery between 2014 and 2017 and the recovery stop abruptly from the second half of 2018, when the difficulties in the automotive sector because added to the halt in world trade of investment goods (Chart 8). In fact, since the diesel crisis hit the German industry, Italy has been strongly affected, losing more than 15 per cent of industrial production in this sector.

In 2019, GDP is estimated to grow at a slower pace than in 2018, dampened again by the drop of industrial production (-1.1 per cent). On the contrary, the construction and services sectors remained on a growing trend. Nevertheless,

Chart 8 - Italy: industrial production index



Source: Prometeia calculations on Istat

there are clear signs of contagion from manufacturing. In particular, wholesale and retail trade, transport, professional, scientific and technical sectors declined, while sectors less related to manufacturing, such as information and communication and real estate activities, recorded a strong growth in 2019.

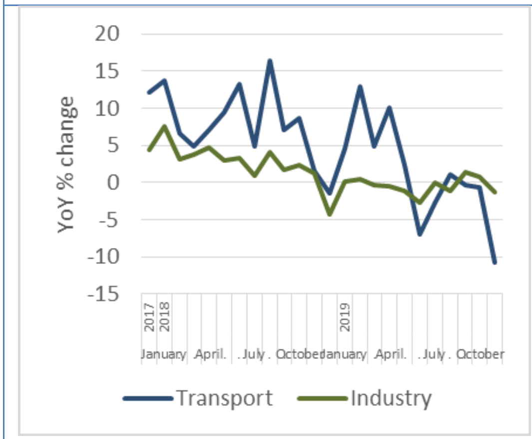
Despite the slowdown in the Italian economy, employment continues to grow and unemployment is at a low level. However, some signs of stalemate are beginning to emerge and the question is now whether the labour market will reverse or whether it is just a temporary setback.

As for the future, we expect that the weakness of the industry may persist for some time; this sector may slowly emerge from stagnation from 2021 onwards and help to bring the Italian economy to growth in line with its potential but still below pre-crisis levels.

The Netherlands

After a growth of at least 2 per cent per year in the previous four years, GDP growth in the Netherlands is expected to fall back to 1.7 per cent in 2019 and 1.3 per cent in 2020. This means that in 2020 GDP growth will be below potential growth. The Dutch economy grew by 0.4 per cent in the third quarter of this year, compared to the previous quarter, equal to the growth in the first two quarters of this year. International trade tensions have had a

Chart 9 - Netherlands: Average daily industrial production



Source: Statistic Netherlands

negative effect on export growth, but also have a negative effect on producer confidence and therefore on business investments. Producer confidence in industry in particular has decreased; the decrease for the service sector was limited. Industrial production has slowed over the past two years (December 2017 to November 2019, see Chart 9). The transport industry has contributed negatively to growth, although the Dutch transport industry is less dependent on the German car industry than other European countries.

Poland

Poland's economic fundamentals have remained healthy despite global trade tensions and economic slowdown in the Eurozone, yet the domestic policies fuel uncertainty and help little to encourage investment.

According to the latest estimations published by Statistics Poland, the Polish economy expanded in the third quarter by 3.9 per cent yoy; the private sector consensus regarding annual GDP growth for the year 2019 averaged at 4.2 per cent yoy, slightly below the National Bank of Poland's and the OECD's expectations of 4.3 per cent. This suggests a slight slowdown, as the relevant data for 2018 indicated a yoy growth of GDP at the level of 5.1 per cent in 2018. Overall consumption in the third quarter of 2019 grew by 4.0 per cent (yoy) slightly below the 2018 growth of 4.3 per cent yoy. Investment as well as industrial production also increased less in 2019 than in 2018, growing respectively by 7.1 per cent and 4.4 per cent yoy (as compared to 8.9 per cent and 5.8 per cent yoy in 2018). Global trade tensions and the recent significant cooling of economic activity in the Eurozone do not appear to have impacted Polish export and import flows yet, both of which have grown at similar rates throughout the last two years.

The prolonged positive development of the economy is also mirrored in the steadily decreasing unemployment rate (reaching 3.2 per cent in November 2019). As demand for workers is unlikely to abate in the near future, we do not expect the trend to reverse in the coming quarters. Indeed, the Polish labour market has benefitted significantly from the influx of Ukrainian workers who provide both qualified and unqualified labour supply. 2019 did not bring changes in the National Bank of Poland monetary policy stance, keeping the reference rate unchanged since mid-2015, at 1.5 per cent. Despite short-term fluctuations, the National Bank of Poland predicts YoY CPI growth rates in 2020 and 2021 to keep steady at 2.8 per cent and 2.6 per cent respectively.

The main challenges for the Polish economic policy in 2020 and later years appear to be focused on maintaining the generous social policy stance, facilitating immigration procedures for workers from outside of the EU. The accepted 2020 budget assumes a 0 per cent deficit (with a projected public finance deficit at 0.3 per cent of GDP, according to the EU methodology). To increase budgetary revenues, the Government has continued to ameliorate the tax system, especially regarding VAT and increased excise (as of 1 January 2020) as well as introduced the tax to new areas such as sweetened beverages (starting in April 2020). These changes have translated into a significant price growth of the relevant products and, as for taxing sugary drinks, it is projected to bring a revenue of ca. PLN 3 billion annually.

Despite both the inflammatory developments in the judicial system and disputes with the European Commission, the Polish economy has boomed, but certain issues remain important for the situation to continue. Indeed, in light of the Government's targeted 3.7 per cent yoy GDP growth (private sector consensus is slightly lower, at 3.4 per cent yoy, with the lowest value at 3.0 per cent) increasing private investment appears key, especially as the trend observed in recent years has indicated a reverse tendency. In this area, the consensus of the private sector for the 2020 gross fixed investment 2020 growth rate averaged at 3.9 per cent, close to the National Bank of Poland's estimates at 4.0 per cent (as compared to 7.1 per cent in 2019). Still, it seems that economic growth will be fuelled the most by private consumption (supported by positive consumer moods), expected to increase 3.9 per cent yoy according to institutional consensus (slightly lower than the 2019 consensus reaching 4.1 per cent).