ING’s Eurozone Quarterly: All systems go

The transformation in the Eurozone's economic fortunes has surprised even us. So what’s really going on, and will the across-the-board growth story continue throughout 2018? Find out in ING's new look Eurozone Quarterly Update

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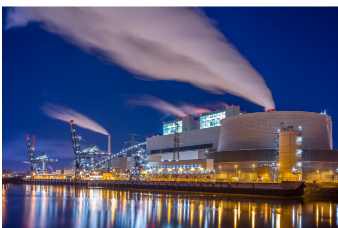

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Eurozone: Full speed ahead

The Eurozone economy is set for a fourth consecutive year of above-potential growth in 2018. While the output gap is gradually closing, inflation is only expected to rise very slowly, keeping in place expansionary monetary policy throughout the year

Source: Shutterstock

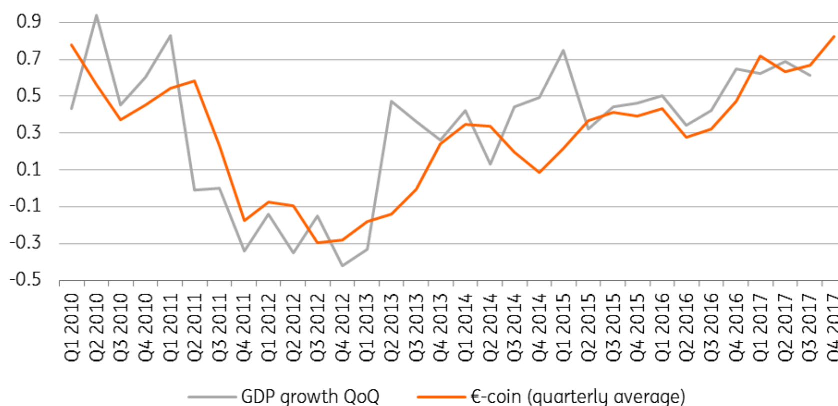
It's all systems go!

The Eurozone recovery seems to be going into overdrive. As far as confidence indicators are concerned, 2017 ended with a bang. The European Commission's economic sentiment indicator (ESI) surged to 116 in December from 114.2 in November. The Business Climate Indicator rose to 1.66, hitting its highest level since 1985. Since October 2016 the Economic Surprise Index has been continuously in positive territory, reflecting an uninterrupted stream of economic indicators coming out better than expected.

The €-coin indicator, a proxy for the underlying growth momentum, hit 0.91% in December, suggesting an above 3% annualized growth pace. While we doubt that this pace will be maintained throughout the year, we believe that GDP growth in 2018 will be at least as good as in 2017. That would be the fourth consecutive year of above-potential growth. With employment rising 0.4% in the third quarter, December consumer confidence hit its highest level since January 2001, boding well for consumer expenditure.

Rising supply constraints and generous financing conditions are likely to continue to underpin the business investment revival. Notwithstanding the strong euro, export perspectives remain upbeat. The rebound in global investment is particularly helpful for Eurozone exports. The assessment of export orders in the manufacturing sector is now at the highest level in 10 years.

Growth pace continues to accelerate



Source: Thomson Reuters

The political angle

True, politics could still cause havoc, but probably not enough to spoil the growth party, we believe. With the pro-independence parties still holding a majority after the regional elections in Catalonia, the problem is not going to be solved rapidly, though we don't think that the Spanish economy will suffer significantly from the current stalemate. That said, some negative impact cannot be avoided. The budget for 2018 has still not been approved, as the Basque National Party is refusing to support the draft budget of Rajoy's minority government, as long as the Catalan issues have not been settled.

Some difficult political problems remain

In Germany, there is still no new government, which is quite unusual for the country. It is still unsure whether SPD party members will give the green light to another grand coalition. However, the biggest problem that the current power vacuum creates is rather European, as in the current circumstances Chancellor Merkel doesn't have a mandate to support ambitious reform plans for the Eurozone. A new grand coalition might be more "euro-minded", one of the demands of Martin Schulz, but it remains to be seen to what extent this is true in practice.

Finally, 4 March has been set as the date for the Italian general elections. At this moment no clear winner looks likely, which will make the formation of a workable coalition difficult, but we consider the likelihood to have an anti-European government quite small (about 10%).

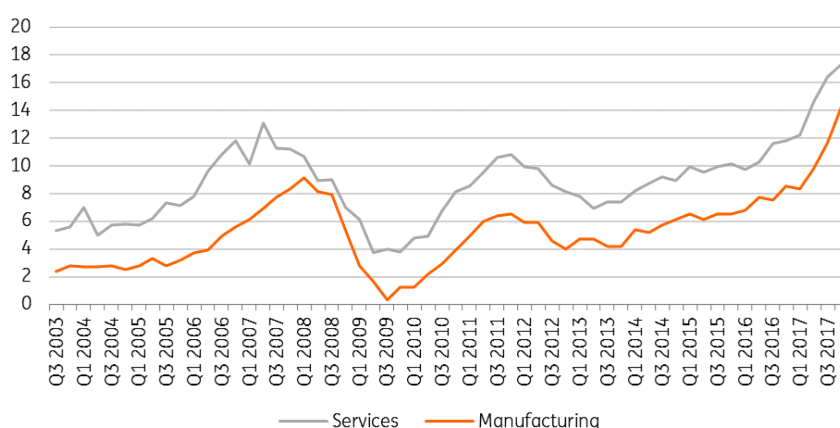
What could spoil the party?

Of course, we cannot exclude sudden shocks on financial markets, which could also temper the growth momentum. As a matter of fact, it would be a surprise if the low volatility and depressed risk premia would remain in place for the whole of the year. In that regard, it still looks wise not to overdo the expectation of continuing above-potential growth.

Be careful not to get too excited

That said, we believe that 2018 GDP growth will come out at 2.4% on the back of a strong base effect and the current growth momentum. From the second half of the year onwards, growth is likely to start converging gradually towards the longer-term growth potential, which for the Eurozone is definitely below 2%. The European Commission now actually expects that the output gap will already become positive in 2018, which limits the potential to continue to expand at above 2% growth rates.

Limits to production



Source: Thomson Reuters

The inflation conundrum

The inflation story is puzzling us. Pipeline inflation is definitely rising, while the labour market is tightening.

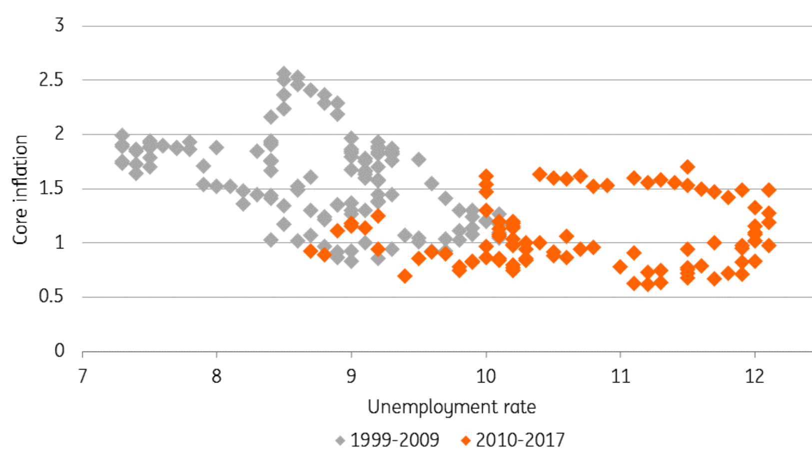
Pipeline inflation is rising rapidly

But we still have some doubts about the speed of transmission into higher inflation rates. In the PMI Manufacturing Survey businesses reported elevated rates of inflation in both output prices and

input costs as supply chain pressures increase, with average vendor lead times lengthening to one of the greatest extents on record.

The unemployment rate, standing at 8.7%, has now been declining continuously since May 2013 to reach the lowest level since January 2009. Looking at the hiring intentions published in the European Commission's Economic Sentiment Survey, this decline is bound to continue. Indeed, in December employment plans reached the highest level in 30 years in industry, while they also improved in construction (to a 10-year high) and in services. The unemployment rate is, therefore, most likely to fall below 8% by the end of this year.

Phillips curve has flattened



Source: ING estimates

A renewed focus on wages

With the percentage of companies mentioning the scarcity of labour as a factor limiting production now at the highest level since the start of the monetary union, wage growth should start to pick up. Annual growth in compensation per employee rose already from a low of 1.1% in the second quarter of 2016 to 1.7% in the third quarter of 2017 and we believe that this trend will continue in 2018.

In Germany IG Metall (where, admittedly, labour tightness is the most advanced), the trade union for the metal and electrical industries, started nation-wide "warning strikes" to support its demand for a 6% pay-rise and a 28-hour working week. Of course, this is not necessarily going to be the outcome of the wage negotiations, but gradually rising wages look likely in an environment of tightening labour markets. That being said, the amount of slack still present in the European labour market means that the increase will be rather at a snail's pace. Core inflation will probably also grind higher, though from its very low current level of 0.9%. Looking at the relatively flat Phillips curve, a fall of Eurozone unemployment to 8% by the end of the year, will probably push core inflation to around 1.5%. That's a step in the right direction, but far from an inflationary shock.

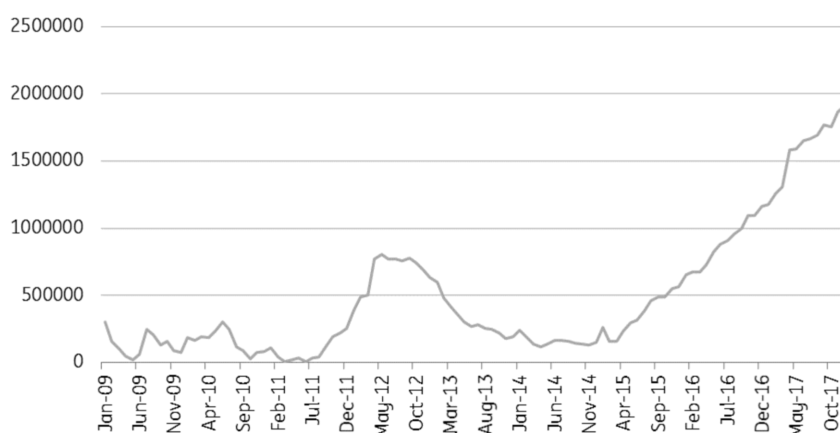
The ECB's next moves

Nevertheless, with the growth picture looking very strong, the calls to end the ECB's expansionary monetary policy will grow louder. The president of the Bundesbank, Jens Weidmann repeated in an interview with Spanish daily El Mundo that the ECB should set an end-date for its asset-buying program. That said, a majority within the Government Council will want to avoid the repeated mistake of premature tightening, certainly given the stubbornly subdued inflation dynamics.

Watch for subtleties in the ECB's communication

But even if backpedalling on its announced QE timeframe looks out of the question, a small change in communication is not to be excluded. Indeed, from the minutes of the December meeting, it transpired that "*the view was widely shared among members that the Governing Council's communication would need to evolve gradually, without a change in sequencing, if the economy continued to expand and inflation converged further towards the Governing Council's aim*". We still expect a short lengthening of the asset purchase program until December 2018, to allow some further tapering. While net asset purchases will definitely have ended at the start of 2019, a first rate hike might have to await the summer of 2019.

Excess liquidity likely to increase further



Source: Thomson Reuters

Excess liquidity

On the back of the ECB's QE program excess liquidity is likely to hit €2000 billion in the course of 2018 and start only to decline very slowly in 2019. As the enormous excess liquidity keeps money market rates close to the ECB's deposit rate, they will most probably remain in negative territory until the summer of 2019. As for bond yields, we believe the QE program will limit the upward shock on yields. However, some contagion effect from higher US yields and the expectations that in 2019 net purchases from the ECB will end is likely to result in a gradual upward trend.

Eurozone economy in a nutshell (%YoY)

	2016	2017F	2018F	2019F
GDP	1.8	2.4	2.4	1.8
Private consumption	2.0	1.9	2.2	1.9
Investment	4.5	4.0	3.9	2.0
Government consumption	1.7	1.1	1.3	1.3
Net trade contribution	-0.5	0.2	0.0	0.0
Headline CPI	0.3	1.5	1.5	1.7
Budget balance (% GDP)	-1.5	-1.3	-1.2	-1.0
Refi rate (eop)	0.0	0.0	0.0	0.25
10yr Bund (eop)	0.30	0.42	0.75	1.10

Source: Thomson Reuters, all forecasts ING estimates

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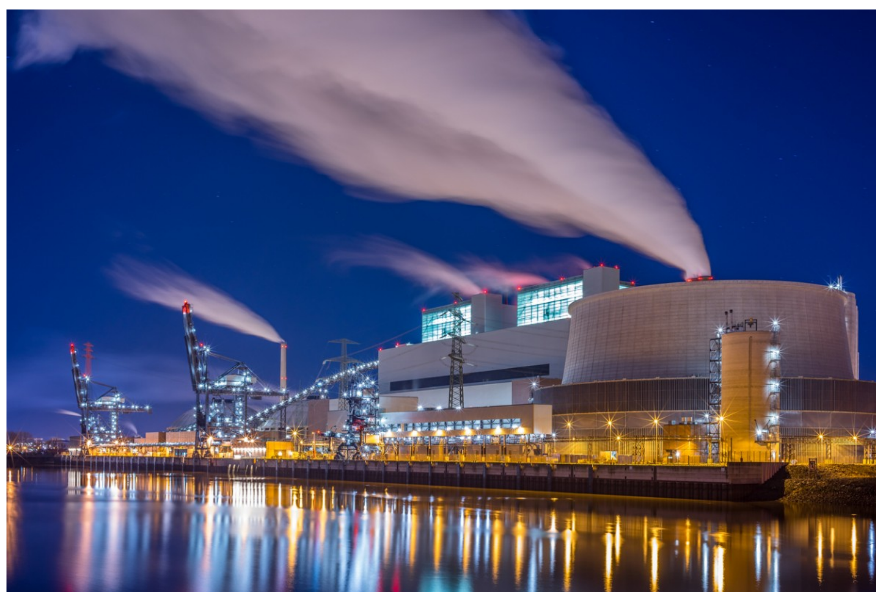
Germany: Change would be good

The German economy continues its almost everlasting boom. The next new government should add some minor fiscal stimulus in the coming years, without going for the big economic strike



Source: iStockphoto

An impressive growth performance

Germans don’t like change. In this respect, 2017 was an excellent year and 2018 has all the ingredients to be another good one. Growth was and should remain strong; all economic sectors were and should continue to be booming and Angela Merkel was and should remain Chancellor. However, at least a little bit of change is urgently needed.

The economy grew by 2.2% (2.5% when adjusted for working days) in 2017. That's a much stronger performance than expected one year ago.

> *Germans don't like change. Therefore, 2017 was a good year and 2018 should also be good*

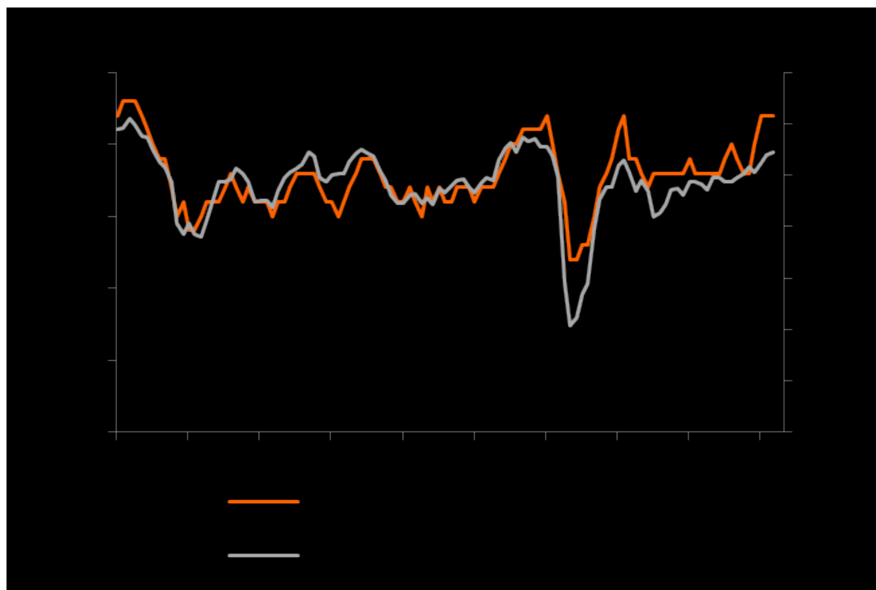
Back then, the German recovery already looked rather stretched. Sentiment indicators stagnated and political risks were rising from Brexit and the upcoming Dutch and French elections. Meanwhile,

the new US administration was fuelling fears of possible trade wars. One year later, the lesson is clear: *"it was not politics, but economics, stupid"*. A strong labour market, low-interest rates and low inflation pushed the domestic economy into sixth gear. Also, instead of suffering from protectionism or a Trump trade war, exports surged to new record highs and the long-awaited investment pick-up finally kicked in. The result: the strongest annual growth performance since 2011. Of the last 35 quarters, the economy grew in 32, with an average growth rate of 0.5% QoQ. That's an impressive performance.

That growth performance is even more impressive given that it has been achieved without any significant structural reforms in the last ten years. In this regard, the German economy is actually a good example of how an economy can benefit extensively from earlier reforms, at least if the external circumstances are right.

2018 should bring more of the same

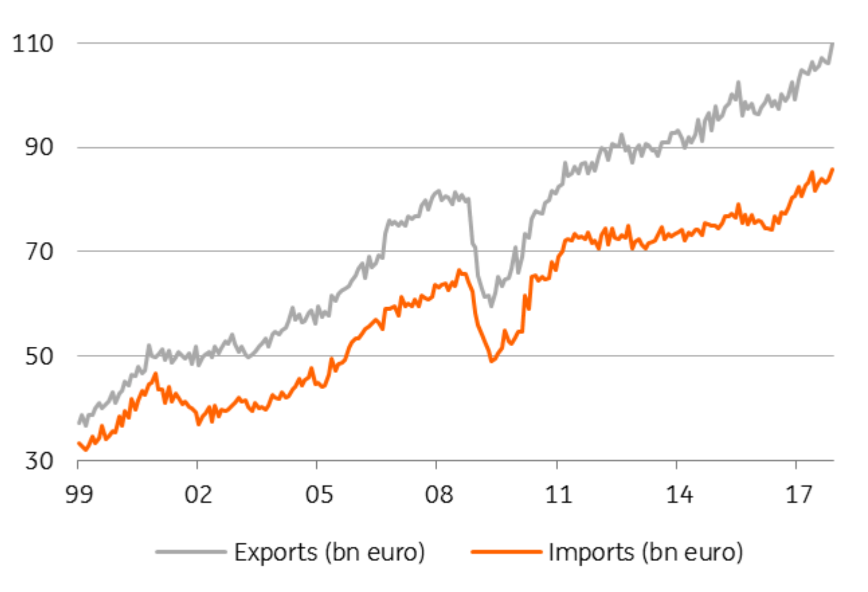
Looking ahead, the same fundamentals which have supported growth in 2016 and 2017 should still be in place in 2018. The only question is how much additional stimulus, low-interest rates, a relatively weak euro, strong domestic momentum and the recent upswing of the entire Eurozone economy can still provide to the mature cycle of the German economy? In our view, quite a lot. Germany still has some upward potential as the output gap is positive but not extraordinary high compared with previous cycles, capacity utilisation is above its historical average but still lower than in 2007 and investments only started to increase last year.



Source: Thomson Reuters

Improving public finances

The strong economic performance has continuously fueled positively into public finances. For the first time since the 1950s, the German government recorded a fiscal surplus in four consecutive years. According to the statistical office, the fiscal surplus came in at 38.4bn euro (1.2% GDP) in 2017, from 0.8% GDP in 2016. While German austerity fetishists will love it, these numbers have been the lubricant for the recent compromise in the coalition talks in Berlin.



Source: Thomson Reuters

The first steps to a new government have been taken

Exactly 110 days after the election, the three parties which have actually governed the country for the past four years agreed to start formal coalition talks. Just to be clear: there is no new German government, yet. But there is a clear determination of the current administration to govern for another four years. The so-called exploratory talks ended with a 28-page-long paper, forming the basis for the coalition talks. According to this compromise paper, which will be the basis for a possible coalition agreement, the next German government will put Europe at the forefront, even though the pro-European stance falls short of clear and concrete measures.

At the same time, the paper remains very vague as to the future of the Eurozone. Phrases such as '*a close partnership with France to reform the Eurozone in order to make it resilient against future global crises*' will make Paris happy but keep lots of room for interpretation. The only concrete plan is to transform the European Stability Mechanism into a European Monetary Fund and enshrine it into European law. Some minor changes to the health care system, an increase in child benefits, some minor tax relief and investments in digitalisation and education are in the offing as far as economic policies are concerned.

All of this would currently add up to a total fiscal stimulus of around 45bn euro over the next four years (some 1.2% of GDP).

Is it a breakthrough? Well, it is a breakthrough in the way that it opens the door for Germany to

finally get a new government.

No big breakthroughs for the economy

However, it is clearly not a breakthrough for the economy. Judging from the paper, the measures are positive for the economy and there are no real economic blunders or obvious electorate gifts such as, for example, the reduction of the retirement age. As far as economic policies are concerned, the agreement is a continuation of the well-known policies of the last few years: cautious steps forward, rather than any visionary experiments. Pro-growth structural reforms, however, are still hard to find.

The political future depends on the SPD grassroots

The destiny of another grand coalition still dangles on a string, a string in the hands of SPD party members. Dissatisfaction at the party's grassroots level and fears that the SPD could lose further electorate support in yet another grand coalition make the outcome of the upcoming party votes anything but certain.

The German economy in a nutshell (%YoY)

	2016	2017F	2018F	2019F
GDP	1.8	2.2	2.2	1.7
Private consumption	1.9	2.3	1.4	1.2
Investment	2.9	4.3	3.2	2.9
Government consumption	3.6	1.1	1.0	1.2
Net trade contribution	-0.4	0.2	0.3	0.1
Headline CPI	0.4	1.7	1.9	1.8
Unemployment rate (%))	4.1	4.1	4.2	4.3
Budget balance as % of GDP	0.8	1.2	0.8	0.2
Government debt as % of GDP	68.2	66.0	63.7	61.7

Source: Thomson Reuters, all forecasts ING estimates

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France: Shifting into higher gear

The picture has changed dramatically in France in just a year. With the highest confidence levels in a decade, it's hard to ignore the positive effects of the reform atmosphere which we expect to continue in 2018

Source: Shutterstock

There is no alternative

Back in the summer of 2017, the polls were suggesting an unconvincing start for President Emmanuel Macron and his government. His approval rating has plummeted, and in August we were among those who thought they could hardly go any lower. Only Mr Macron’s base looked satisfied with his first steps, but five months later, all of that has become history.

An IPSOS poll indicated in January 2018 a 53% approval rating for the President and almost 60% for Prime Minister Edouard Philippe. Part of it is due to the disarray of the opposition in polls, and another is the lack of stability at a low level on the right. President Macron seems to leave no space for an alternative. His first successes on the Labour Law and the 'moralisation law', which didn't trigger the feared street opposition, give a sense something is finally happening.

This should continue, with expected 2018 reforms to ease businesses’ life cycles from creation to transmission. The Government should also start spending its 50bn euro investment plan, which also entails new employment schemes for the unemployed. On top of that, the Government will have to take risks on two politically sensitive reforms: the Immigration Law and Constitutional Reform, which aims to lower the number of MPs and limit the number of offices they can hold.

President Macron is therefore likely again to be all over the place in 2018, showing France that there is no alternative.

One could note that the Philippe Government does not look keen on austerity as the bulk of the 80bn euro of spending cuts scheduled for the next five years have been pushed back to after 2020. If the target is still to reduce public spending from 55% to 51.1% of GDP between 2016 and 2022, delaying the process could bring the deficit to GDP ratio above 3% in 2020, although stronger growth will help the consolidation of public finances.

Read this article in French here

2.0%

Better than expected

Expected 2018 GDP growth

The highest since 2011

High business confidence will increase support for reforms

If there is one supporter of further reforms in France, it is probably the strong economic context, which is due both to the reform momentum and the high-cycle dynamism of the rest of the Eurozone. So far, the high confidence level has been broadly spread across sectors and suggest that the domestic economy should continue to grow strongly in 2018.

In the manufacturing sector, activity is set for a 2.4% rebound in 2017 after a paltry 0.4% YoY in 2016. As activity started 2018 at the same level as in October 2008, there is room for further recovery. With confidence indicators at a ten-year high, we expect 2018 manufacturing growth to reach 4%. Most companies in the manufacturing sector have remained upbeat about the general economic outlook since October and order books were still at their highest levels of the last ten years in December.

High confidence is spread across different sectors

Prospects are just as bright in the building sector where confidence also reached a high point at the end of the year, as expected activity is on the rise. Low-interest rates and a recovering housing market is essential for this sector which has been in recovery mode for the last three years. The December survey showed that hiring intentions remain high in building activities.

In the service sector, the rise in confidence looks more sustainable than in early 2017 as it is supported by the highest confidence level in the general outlook in years. Hiring intentions in services recovered in December to their high mark of last April which, together with similar signs from the building sector, is great news for the job market. Finally, even the retail sector gave signs of a revival of its hiring intentions as this component of the survey was above zero for the first time since 2012.

Expect further improvements to the labour market

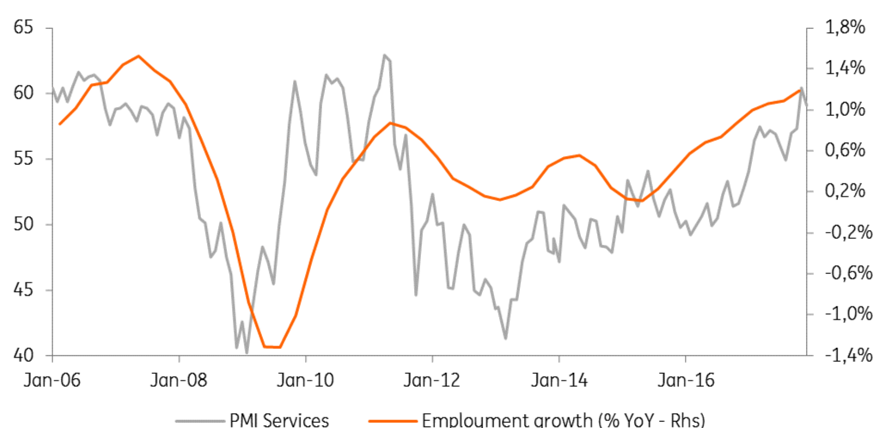
But as we all know, it takes time to translate these good intentions into higher employment growth.

The French recovery started at a slow pace in 2014, boosting private employment growth only very slowly. It took three years to go from 0.0% growth on average to 1.4% YoY in 2017 (9 first months).

This rhythm is, however, still too low to trigger a fast decline in unemployment. French unemployment was still at 9.4% in 3Q17, higher than at the beginning of the year. An explanation is that 72.4% (on average) of unemployed people who were on one of President Hollande's subsidised job schemes or training did not find a job after that period and they are now flowing back into the unemployment statistics. Over the first ten months of 2017, this amounted to 65-thousand, which explains why the unemployed population has increased by 16-thousand so far in 2017 after the 113-thousand decline in 2016, despite the acceleration of the recovery in the second half of this year.

That said, with GDP growth accelerating towards 2% in 2018 and supportive labour market reforms, employment growth should accelerate further in the second half of this year. This should allow for unemployment to decrease to 9% at the end of the year.

Improvements in the service sector are key to support employment growth



Source: Thomson Reuters

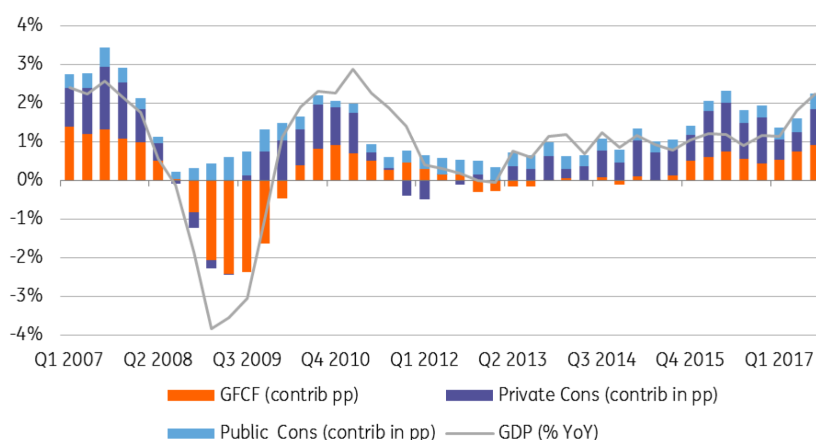
Domestic demand remains strong

Domestic demand growth was back at its mid-2016 level in the third quarter. The difference is that this year's growth is more balanced between investments and consumption: contribution from investments to GDP growth was 0.9pp in the third quarter, its highest level since 2010. Private consumption contributed the same. Corporate investments are particularly dynamic given that higher activity levels are pushing up capacity utilisation which is driving corporate investments.

Moreover, under Macron, the corporate tax rate will be cut from 33% to 25%. In 2016, the growth contribution of business investment was almost entirely due to fiscal measures. The effect was short-lived. This time it is driven by demand, which is why we expect the rebound to be sustained in 2018 and 2019 where we expect growth of 5% and 4.2% respectively, after 4.4% this year. Together with strong households' investments (still backed by low-interest rates and the prospect of housing tax cuts), this should bring investment growth from 3.6% in 2017 to 3.9% this year.

Private consumption should also continue to recover as consumer confidence will benefit from declining unemployment and tax reforms. While the Hollande era was often synonymous with higher taxes in people's mind (although this is not true on average), PM Philippe has been avoiding that reputational mistake. If his Government were criticized at first as "*the Government of the rich*", the fact is that purchasing power among workers should rise in 2018, while a flat 30% tax on financial income has consolidated a number of schemes. We expect private consumption growth to catch up to its 2016 level in 2018 (2.2%) after 2017's blip (at 1.2% only).

Investments posted their strongest contribution to GDP growth in 10 years



Source: Thomson Reuters

Demand should ensure record growth in 2018 and 2019

Growth will therefore continue to be mainly based on domestic demand. So far, the negative contribution of net exports in 2017 has been compensated by inventory effects but it will nevertheless be -0.6pp, somewhat less negative than in 2016 (-0.8pp). We expect export growth to recover in 2017, at a healthy 3.4%. However, the recovery in private consumption and investment goods' demand will probably be quicker, leaving negative external trade contributions for 2018 and 2019.

> *All in all, the picture has changed dramatically in France in one year*

The economic recovery is shifting into higher gear, backed by the highest confidence levels of the last ten years. It is hard not to recognise the positive effects of the reform atmosphere the Philippe Government has succeeded to install. Even if most measures will not take effect before some months, expectations can be built on stronger ground. We expect reforms to continue in 2018, which should help GDP to reach 2.0% this year. With a popular PM and a weak opposition, it seems the path to reform hasn't been this clear since 2007, an opportunity that President Macron certainly intends to seize.

	2016	2017F	2018F	2019F
GDP	1.1%	1.8%	2.0%	1.9%
Private consumption	2.1%	1.2%	2.2%	2.0%
Investment	2.7%	3.6%	3.9%	3.5%
Government consumption	1.2%	1.5%	1.8%	1.8%
Net trade contribution	-0.8%	-0.6%	-0.5%	-0.6%
Headline CPI	0.2%	1.0%	1.2%	1.5%
Unemployment rate	10.0	9.6	9.1	8.5
Budget balance as % of GDP	-3.4	-2.9	-2.9	-3.1
Government debt as % of GDP	96.5	97	98	98

Source: Thomson Reuters, all forecasts ING estimates, unemployment rates according to ILO definition

Italy: Election time, finally

Italy is approaching the 4 March general election with the economy in full recovery mode, but there's a high chance of an inconclusive result

Source: Shutterstock

Domestic demand drive continued in 3Q17

Italy is approaching election time with the economy expanding at a decently good pace. But don't expect a clear-cut election victory for any party. Forming a new majority will take time and a caretaker government, headed by the current Prime Minister, Paolo Gentiloni (pictured with Germany's Angela Merkel last year) would help contain the risk of a confidence crisis.

Economic prospects are looking decidedly more promising. In the third quarter of last year, Italian GDP expanded by 1.7% YoY, driven by domestic demand. Interestingly, private investment continued gaining ground, overtaking private consumption as the leading contributor to quarterly growth. A solid export performance was behind the marginally positive contribution of net exports to quarterly growth. The unexpectedly sharp decline in inventories was a cause for temporary concern, as forward-looking indicators suggest a possible rebalancing in 4Q.

Confidence and employment data remained supportive in 4Q

However, economic momentum still seems to be in place throughout 4Q17. Manufacturing business confidence climbed further, propelled by the capital goods component; services business confidence, a closer proxy of domestic demand developments, continued catching up.

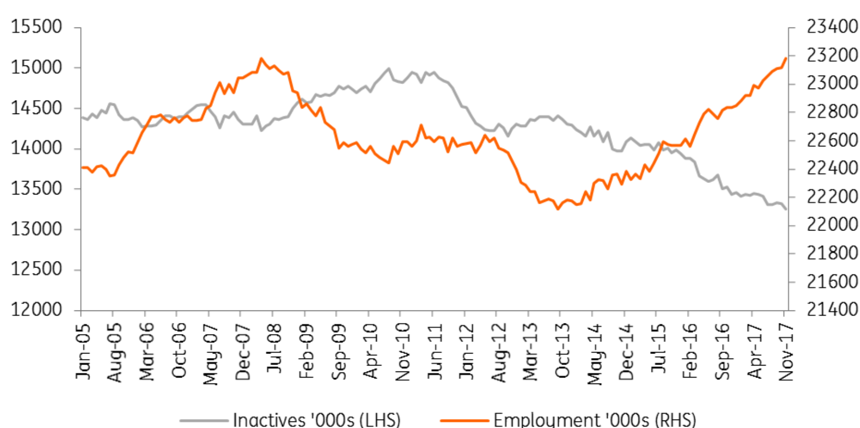
Improving economic conditions are reflected in further employment gains

The headline employment number returned to pre-crisis levels in November. Admittedly, the bulk of new jobs are temporary in nature but, nonetheless, they help boost disposable income and ultimately private consumption. Taking into account confidence improvements, disposable income developments, rising capacity utilisation and healthy foreign order books, we end up with a 0.4% QoQ growth estimate for 4Q17 GDP, which would translate into a 1.5% average yearly GDP growth for the whole of 2017.

Good chance of a symbolic marginal decline in debt/GDP ratio

Stronger than anticipated economic growth might have as a positive side effect in marginally reducing the debt/GDP ratio in 2017. A projected 2.1% deficit/GDP ratio and the impact of some debt buybacks done by the Italian Treasury over December could have been enough to drive a symbolic 0.2% decline in the debt/GDP ratio. We will have the verdict on 1 March, just three days before the day of the Italian general election.

Employment now back to pre-crisis level



Source: Reuters Datastream

The Italian electoral system

Italians will vote in March with a mixed electoral system, where two-thirds of the seats are attributed on a purely proportional basis, and a third with first-past-the-post rules where coalitions will be possible. In the current political setting, no party seems to be in a position to approach the absolute majority in isolation.

General elections, scheduled for March 4, will be the key Italian

event in 1Q18

Still, forming a coalition is not proving easy. As we write, only the centre-right parties have been able to assemble a coalition to compete for first-past-the-post seats. This will put together Forza Italia, Lega Nord, Fratelli d'Italia and Noi con l'Italia. On the centre-left front, the attempt to form a coalition has so far scarcely proved to be fruitful. The PD will likely end up coalescing with part of the centrists and with liberals, but not with Liberi e Uguali, a new political formation born from the convergence of smaller parties positioned to the left of the PD party. Finally, as we've known for a while, the anti-establishment 5Star Movement will run in isolation.

An outright win is extremely unlikely

Managing to form a coalition is unlikely to be enough to earn an outright victory. Opinion polls suggest the centre-right grouping would currently earn 36.5% of votes in the proportional part. A centre-left coalition (including the PD and centrists, but without the left hardliners) could get 28% and the 5Star movement 28%. According to some estimates given the current situation, even the leading centre-right coalition would need to win at least 70% of available first-past-the-post seats to approach the absolute majority in the parliament. That's a very unlikely occurrence, in our view. The current political picture clearly seems conducive to a hung parliament.

The formation of any government will likely call for some form of broader coalition after the vote

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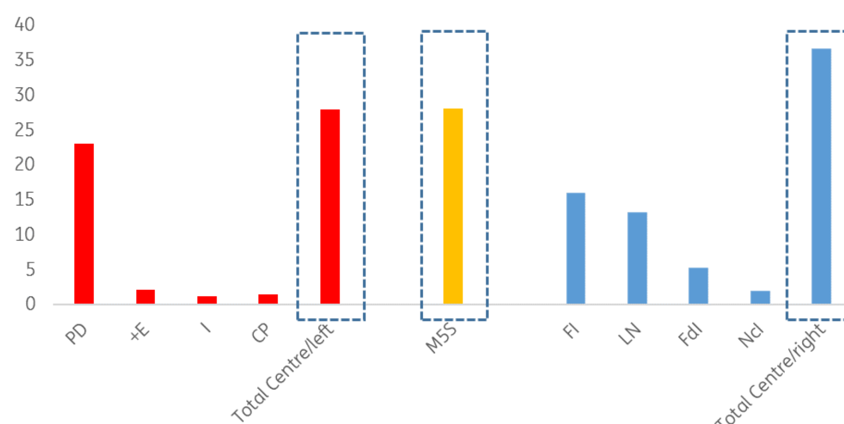
Such a recombination of factors might well involve a break-up of original coalitions. Against this backdrop, the electoral campaign which has just started might see parties fiercely competing with (and mistrusting) other members of their own coalition, well aware that from day two the coalition itself might disintegrate. Such a framework increases the risk of the proliferation of (financially) untenable promises made during the campaign to maximise the electoral score to increase post-vote bargaining power.

The good news is that in this process the most extreme and potentially destabilising calls such as that of the (not admissible) referendum on 'Itexit', Italy leaving the European Union by the Five Star Movement are being progressively attenuated by their proponents. Some noise-filtering practice will be needed during the campaign to pin down what an eventual grand coalition could be able to converge upon.

January opinion polls indicate no outright winner, even with coalitions



Source: Various sources, ING

A possible caretaker government

As happened elsewhere, an inconclusive electoral result might also mean an unusually extended time frame to craft a new majority. Over that period, with president Mattarella busy exploring possible solutions, the current Gentiloni government would remain in place to avoid a political vacuum, acting as an empowered caretaker. Such temporary continuity, and, no less importantly the fact that a flexible ECB will still be active with its Public Sector Purchase Programme, should all help reassure the market, limiting the scope for a substantial spread widening in government bonds. Should any attempt fail by the summer, the risk of another election in the autumn would likely increase, and market nervousness with it.

The Italian economy in a nutshell (%YoY)

	2016	2017F	2018F	2019F
GDP	1.1	1.5	1.3	1.2
Private consumption	1.5	1.5	1.2	1.1
Investment	3.0	3.2	3.3	2.3
Government consumption	0.5	0.8	0.5	0.5
Net trade contribution	-0.2	0.0	0.0	0.1
Headline CPI	0.0	1.3	1.3	1.5
Unemployment rate (%)	11.7	11.2	10.9	10.6
Budget balance as a % of GDP	2.5	2.1	1.8	1.6
Government debt as a % of GDP	132	131.8	130.4	128.6

Source: Thomson Reuters, all forecasts ING estimates

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The Netherlands: Maintaining strong growth momentum

The Dutch economy should maintain a high growth rate in 2018; it's broad-based, consumer spending is high but labour market pressures are appearing

2.9% Netherlands GDP growth rate

2018 (YoY%)

Domestic demand is driving economic growth

We forecast GDP growth of 2.9% for the Netherlands in 2018. Increasingly, growth is driven by domestic demand; consumers keep spending more and business investment continues to grow. On top of that, the coalition agreement of the new Rutte III government involves additional public spending. This will provide an additional boost to domestic demand and prevent growth from slowing down considerably after the impressive GDP figure projected for 2017. New policies also explain the upward revision of our 2018 forecast. The additional spending comes at the expense of public finances. Nevertheless, a budget surplus is projected for 2018 (+0.5% GDP).

Read our first thoughts on the Rutte III coalition agreement

Import growth outpaces export growth

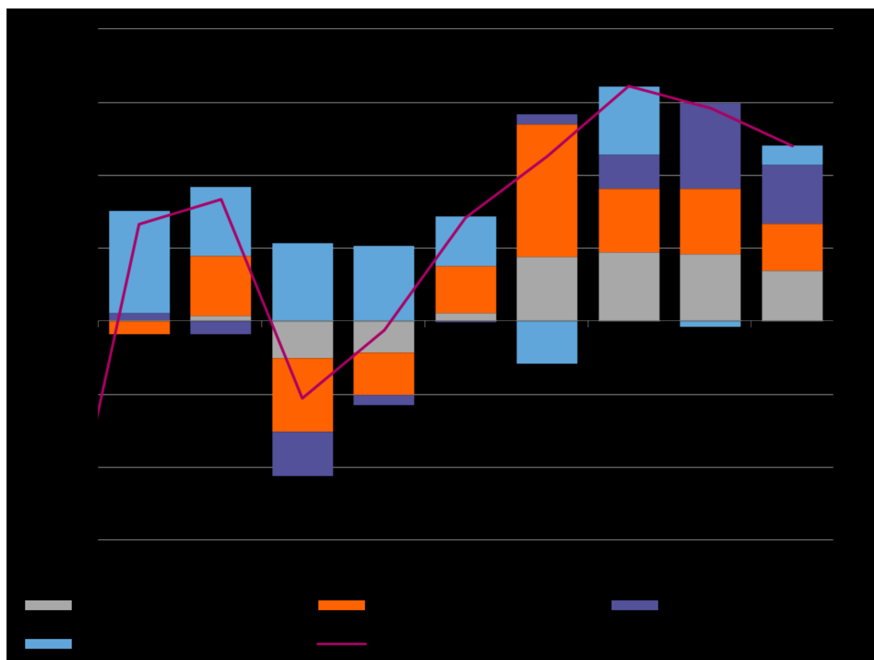
Exports are expected to grow at considerable pace, projected at 5.6% for 2018. Yet, the net contribution of foreign trade will be close to zero. Imports are forecast to grow fast. In fact, import growth in percentage terms will be faster than export growth because of the strength of domestic demand as well as due to the government's decision to further lower the maximum permitted gas production in the northern province of Groningen. Level-wise, exports will remain much higher than imports, maintaining a large current account surplus.

Sector-wise, growth has become broad-based

All sectors in the real economy are seeing growth in volumes. The exception is gas production, which locally faces a legal production limitation aimed at mitigating earthquakes in the province of Groningen. Industry is benefiting from growing investment in the Eurozone, while wholesale and transportation will also deliver above-average growth thanks to solid export growth. Commercial services, including IT and job agencies, construction and health care are growing at the highest rates.

Download our Dutch Economy Chart Book here!

Strong domestic demand driving high growth



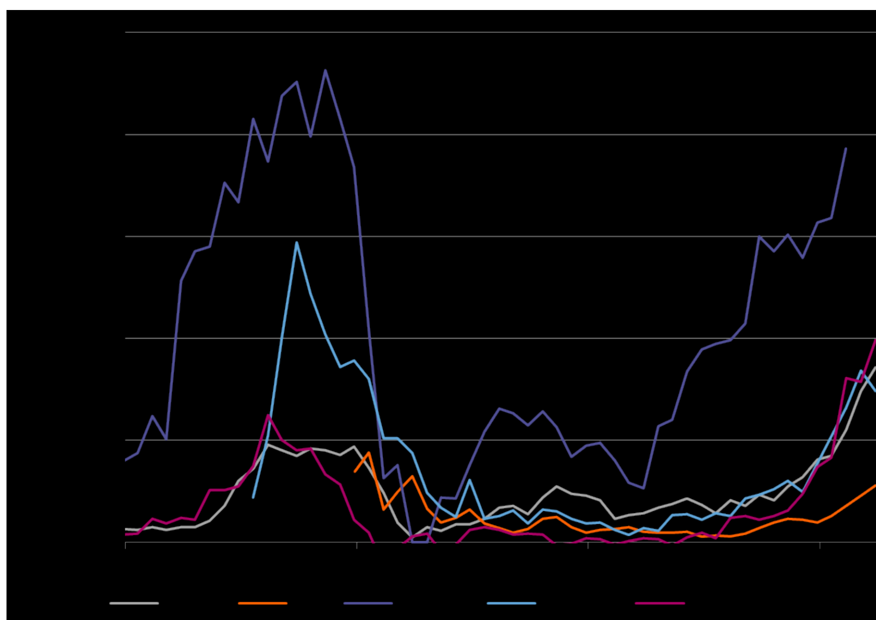
Source: Macrobond, ING estimates for 2017-2019

First signs of labour shortages

While unemployment has already passed the estimated natural rate, we forecast it to fall further, to 3.9% in 2018. Due to the persistent demand growth, the first signs of shortages in the labour market are appearing. One in six businesses is reporting a shortage of workers as the main factor limiting production. In the IT-sector this was already an increasing problem for quite a while, with currently 39% of businesses reporting shortages. Now, concerns are also becoming increasingly prevalent in construction, hospitality, industry and transportation.

While much of the initial rise in employment was achieved with flexible and temporary contracts, the most recent figures show that fixed contracts are finally also on the rise with considerable numbers. While the self-employed, who represent a large and increasing share of the labour force, took a large hit in their income as the result of the crisis, they appear to have achieved higher income growth rates than employees in recent years. This trend is expected to continue in the short run.

Signs of increasing labour shortages



Source: Macrobond

Consumer price inflation remains subdued

Although shortages are rising, labour market pressure is not yet back at the levels prior to the crisis. It will therefore only gradually translate into higher wages. As a result, price pressure will increase, but with a lag. Being forecast at 1.5%, consumer price inflation will remain subdued in 2018 and very much in line with Eurozone inflation rates.

Public finances in line with European norms

The new government has decided to spend more money on defence, education, Research & Development, civil service and infrastructure. The output gap appears to be closed, meaning that the expansionary fiscal policy will be pro-cyclical. Government finances continue to benefit from the fast-growing economy. Budget surpluses will, therefore, remain during the entire term of the third government with Mark Rutte at the helm, despite the additional spending and tax cuts. Public finances are and will remain in line with European norms. Government debt has already dropped below the 60% GDP norm and will continue decreasing as a result of cumulating surpluses and the continuation of the sale of the ABN AMRO bank and insurer ASR.

The Dutch economy in a nutshell (%YoY)

	2016	2017F	2018F	2019F
GDP	2.2	3.2	2.9	2.4
Private consumption	1.6	2.2	2.2	1.6
Investment	5.3	7.1	5.7	3.2
Government consumption	1.2	0.7	3.3	3.0
Net trade contribution	0.6	0.9	-0.1	0.3
Headline CPI	0.3	1.4	1.5	2.5
Unemployment rate (%)	6.0	4.8	3.9	3.6
Budget balance as % of GDP	0.4	0.7	0.5	1.5
Government debt as % of GDP	61.8	57.3	50.4	47.4

Source: Macrobond, all forecasts ING estimates

A strong growth figure for 2019 along with higher inflation

Looking at past upturns, there still seems to be plenty of room for the Dutch economy to grow after 2018. The next 'bust' is not expected to materialise any time soon. Our current forecast for GDP growth in 2019 stands at 2.4%. Growth is expected to normalise steadily towards the potential annual rate of 1.7%, but we forecast quarter-on-quarter rates for 2019 which are still slightly above that rate. Due to rising wage pressures as a well as the increase of the special VAT-rate, which will notably affect food items and some services, CPI inflation will be much higher in 2019. The inflation rate is currently projected at 2.5%.

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Spain: Decelerating after a great run

After three years of above 3% growth, we expect momentum to slow somewhat in 2018 and 2019. The situation in Catalonia will not be resolved anytime soon and could be a further drag on the economy

The growth momentum

In terms of activity in 2017, there is nothing to complain about. With an annual growth rate projected to be 3.1%, Spain remains one of the fastest growing economies in the Eurozone. Growth momentum remains healthy for now, as PMIs for both the services and manufacturing sectors ended the year on a high note.

Domestic demand, which has provided a positive annual contribution to growth since the first quarter of 2014, continues to be the main driver of growth. As in 2016, private consumption remained the largest contributor to growth in 2017, although its importance declined. In contrast, the contribution of investment rose. In the third quarter of 2017, the YoY growth contribution of investment of 1.2 percentage points equalled that of private consumption.

External demand was another growth engine

Despite the troubles in Catalonia, Spain saw a record number of visitors in 2017, with the number

of tourists increasing by nearly 9% YoY. However, with imports now also accelerating on the back of stronger domestic demand, the positive growth contribution of net exports was somewhat smaller in 2017 than in the previous years.

The labour market performed well last year. In the third quarter, employment grew at 2.8% YoY. Accordingly, the unemployment rate declined to 16.4% in the third quarter from 18.9% a year earlier. For 2018, we expect the unemployment rate to be 16% before dropping to 15% in 2019. This positive evolution, however, is still likely to result in a higher unemployment rate than before the financial crisis of 2009 and remains one of the highest in the Eurozone. The projected decline in unemployment will nevertheless continue to support private consumption in the coming quarters, although to a lesser extent.

Absolute changes of unemployment rate are highly correlated with consumption growth

Source: Thomson Reuters

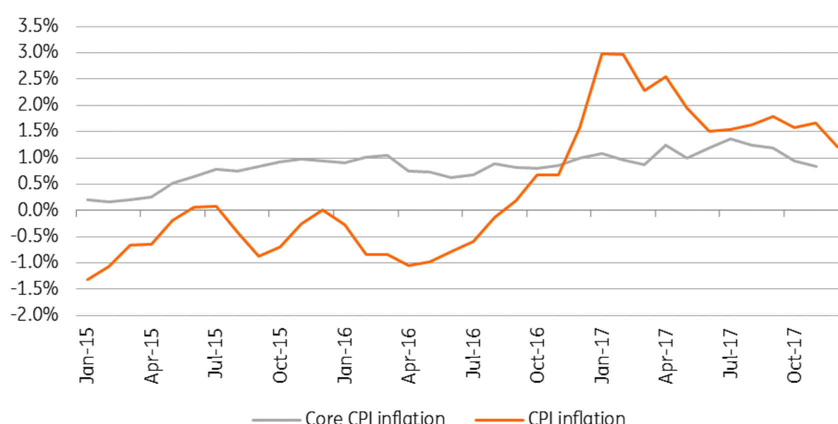
Headline inflation to converge towards the core rate

Headline inflation moderated in the second half of 2017. In the fourth quarter, headline inflation had come down to 1.5% from 2.7% in the first quarter. Core inflation, however, has remained around 1% since mid-2015. As the base effect of oil prices fades away, we expect headline inflation to converge towards core inflation. We think, however, that core inflation will edge upwards, although at a slow pace, as the cyclical slack in the economy only gradually disappears. We expect a headline inflation rate of 1.5% in 2018 and 1.7% in 2019.

The government deficit is expected to have declined from 4.5% in 2016 to 3.1% in 2017. This is mainly due to a strong macroeconomic performance, which supports tax revenues and limits social security expenditures. We expect this trend to continue and forecast a deficit of 2.6% in 2018 and 2.4% in 2019. Government debt is also set to decline as nominal growth offsets the negative budget balances.

Headline inflation will converge towards core inflation

While core inflation is likely to slowly edge upwards



Source: Thomson Reuters

Politics muddle the picture

A big question mark is how the situation in Catalonia will unfold. The results of the Catalan snap elections last month show a divided region. The three pro-independence parties obtained a majority of seats in the Catalan parliament but did not receive more than 50% of the vote. The separatist parties agreed to re-elect Puigdemont as president of the region. However, it is not certain whether this will be possible from a constitutional point of view, as Puigdemont still resides in Brussels so a clear-cut solution doesn't seem to be in the offing.

Political concerns haven't gone away

Unfortunately, the longer this process lasts, the more harmful it could be for the economy. According to Spain's economy minister, the Catalan crisis already cost one billion euro in the fourth quarter, although this kind of calculation is notoriously difficult to make. On the other hand, the main Catalan pro-independence parties have somewhat softened their stance and for the time being have backed away from unilateral independence, which diminishes the risk of greater turmoil.

All in all, the macroeconomic situation remains rosy, although we expect the economy to slow a bit. The Spanish government is planning to increase its growth forecast for this year from 2.3% to at least 2.5%. This seems realistic in our view as we expect the Spanish economy to grow by 2.6% in 2018 and by 2.0% in 2019, compared to 3.1% in 2017.

	2016	2017F	2018F	2019F
GDP	3.3	3.1	2.6	2.0
Private consumption	3.0	2.5	2.2	2.0
Investment	3.1	4.7	3.2	2.5
Government consumption	0.8	1.1	0.9	0.8
Net trade contribution	0.9	0.6	0.5	0.3
Headline CPI	-0.3	2.0	1.5	1.7
Unemployment rate (%)	19.7	17.3	16.0	15.0
Budget balance as % of GDP	-4.5	-3.1	-2.6	-2.4
Government debt as % of GDP	99.0	97.3	96.1	95.1

Source: Thomson Reuters, all forecasts ING estimates

Article | 18 January 2018 Greece

Greece: Waiting for the exit debate to become serious

The Greek economy is finally back on a recovery path, driven by domestic demand. While the growth pace has so far been unspectacular, things are improving

Source: Shutterstock

Back on a recovery path

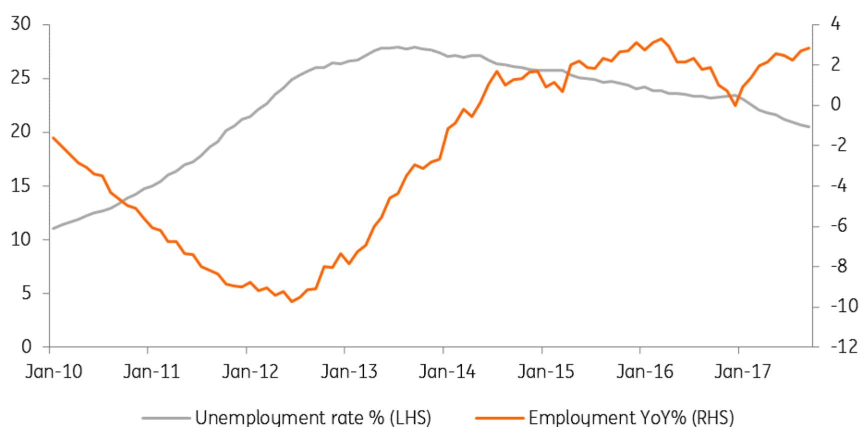
Macroeconomic fundamentals have been improving in Greece. Labour market indicators have turned around. In 3Q17 employment was growing at 2.6% year-on-year, helped by a strong summer tourism season. The unemployment rate continues to decline, reaching 20.5% in September.

Crucially, the combination of an improving economic backdrop and consistent signals that fiscal austerity had come to an end, have been reviving confidence indicators, and consumer confidence in particular.

The approval of the 2018 budget was accompanied by the so-called social dividend - money handouts paid to Greek citizens hit particularly hard by the crisis, agreed with the institutions within the framework of the Third Greek programme. Public finance developments over 2017 have been positive in general, with good chances that Greece will meet its 1.75% of GDP primary surplus target. To be sure, tax collection issues remain but the government proved able to compensate by

controlling expenditure.

Turnaround evidence showing up in labour market data



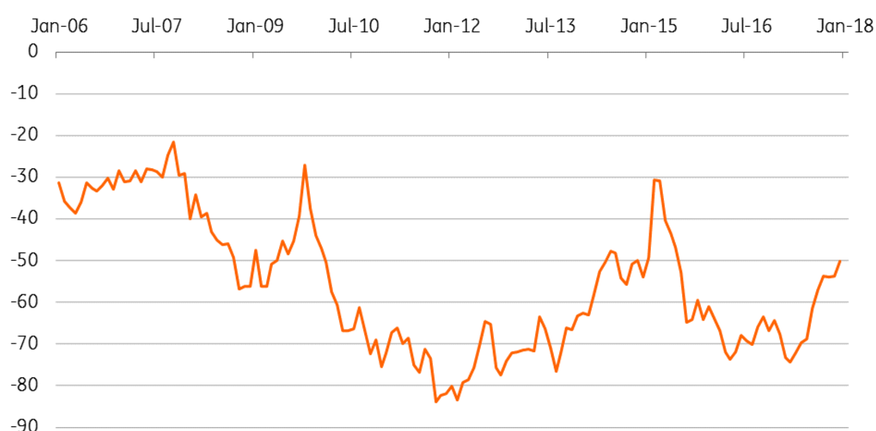
Source: Thomson Reuters

Approval of the omnibus bill might just open the door

Looking forward, Greek economic developments will clearly depend on a smooth end to the third European Stability Mechanism (ESM) programme. The approval from the Greek parliament of an omnibus bill meant to close 50 out of 60 prior actions is expected to open the door to the completion of the Third Review, possibly by the end of January.

Soon after that, the Greek government is expected to tap the market with a new bond to create a cash buffer given the end of the programme in August 2018.

Consumers getting more upbeat on growth/fiscal relief evidence



Source: Thomson Reuters

Grexit strategy expected to pick up

February might also be the time when discussions on the way Greece will exit its third programme will get serious. So far, this has remained within the Greek borders, with the Bank of Greece governor Yannis Stournaras backing the idea of a precautionary credit line as a safety net and Prime Minister Alexis Tsipras sticking to his clean exit view.

European partners will not be allowed to sit on the fence for much longer and will have to take a clear stance, which will have to include their ultimate view on the future of debt relief.

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Article | 18 January 2018

Eurozone: Housing market to remain strong

Housing markets have been recovering in the Eurozone since 2012 mostly supported by low-interest rates, supply shortages and increased demand

Across the Eurozone

After a growth rate of 2.3% in 2016, house prices have grown by 3.5% in 2017. This growth has been supported by interest rates that remain very low, supply shortages in some countries and an increase in disposable income and hence demand. In 2018, we expect house prices to grow by 3.3% which is slightly higher than our previous forecast.

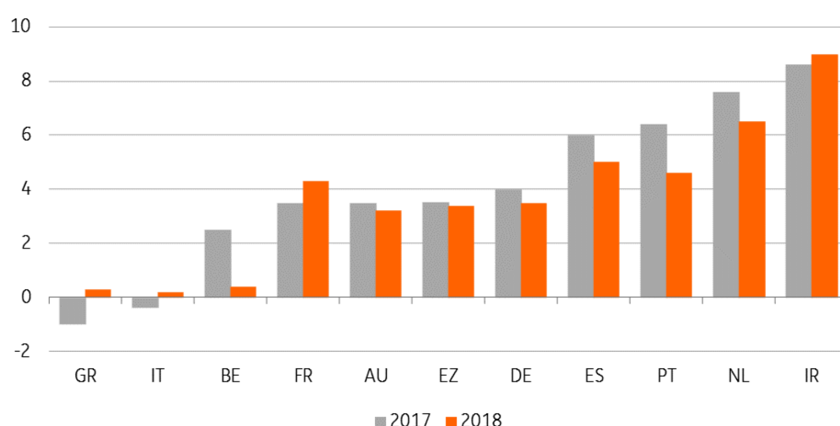
With consumer confidence at its highest level since 2001 and still very generous financing conditions, the recovery should continue, which in turn is positive for activity levels and employment growth. Business confidence in the construction sector reached levels in 2017 not seen in the last ten years and hiring intentions followed. This is likely to decrease supply shortages where they still exist, limiting house price growth somewhat in the whole Eurozone in 2018.

In 2018, we expect house prices to grow by 3.3% which is slightly higher than our previous forecast (3%), due to the upward revision of forecasts in some countries. While still being a

high figure, it implies a slight slowdown compared to 2017, which is logical as long-term interest rates should start to make mortgages slightly more expensive this year. This should continue in 2019 where we expect a 2.8% price growth. Having said that, house price growth should remain firmly above inflation.

As a final note, keep in mind that the 3.3% expected growth figure is a weighted average of all the constituent countries of the Eurozone that can have very different individual situations.

Housing price growth forecasts across the Eurozone (in %)



Source: ECB, ING

Italy

In Italy, the ongoing recovery of the economy remains positive for the housing market. For the time being this has been reflected in higher house transactions, but at a declining pace. In 3Q17 the number of house transactions was up by 1.5% YoY (3.8% YoY in 2Q17), down from two-digit growth clips recorded in 2016. Improved affordability is making the purchase more attractive. The recovery in loans for house purchases continues at a stabilised 2.1% yearly rate.

The December 2017 Bank of Italy-Tecnoborsa survey showed that the loan to value ratio, at 74.4% is now higher than before the outbreak of the great financial crisis and is stabilizing, as is the ratio of house purchases financed via mortgages, now at 78.8%. The same survey showed that the average discount from the original offer price resumed declining and reached 10.2% (from 12.5% in 3Q). Latest Istat house price data shows a divergence between existing homes (still declining) and new homes (picking up). We expect the ongoing moderate recovery of disposable income, in conjunction with still cheap mortgages, to support further house purchases. However, the ample slack in the market should prevent a big short-run showing on prices. We expect house prices to be marginally negative in 2017, and to edge up only slightly in 2018.

Spain

In Spain, due to growing disposable incomes and lower unemployment, the house price recovery is still accelerating, reaching 6% in 2017 after 4.7% in 2016.

As house prices remain 25% below their pre-crisis levels, there is still room for recovery. We expect house prices to grow by more than 5% a year in 2018 and 2019.

Greece

In Greece, signs of an economic turnaround are getting more consistent, but the recovery in disposable income is still at an early stage. Notwithstanding the ongoing decline in the unemployment rate, slack in the labour market remains ample, and the delicate position of Greek banks and their Non Performing Loans is still weighing on house-purchase related mortgage lending. In November, lending for house purchases was still contracting at a 9.3% YoY clip. Furthermore, very high property taxes in Greece continue to discourage demand in our view. Still, in 3Q17 the contraction of house prices slowed down to -0.6% YoY (-1.2% in 2Q17), signalling that stabilisation is possibly in sight. We see the YoY price contraction to end in 1H2018 and to turn very marginally positive thereafter.

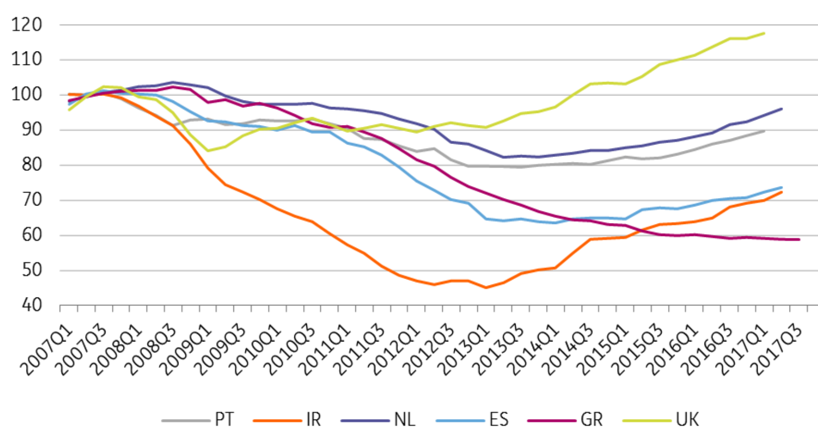
This will very much depend on how Greece will be able to exit the third programme.

Portugal

In Portugal, the domestic-demand based recovery of the economy continued over 2H17. While credit conditions remain very favourable for borrowers, lending activity has been hampered by the ongoing private sector deleveraging. In the short run, the real estate market seems strongly supported by the recovery in disposable income and, price-wise, by an insufficient construction rate. International investors are often reported as a key player, particularly in metropolitan areas. As employment growth is proving stronger than originally anticipated, we believe Portuguese house price developments to remain upbeat for most of 2018, and to decelerate after that as the very high elasticity of employment to GDP growth will start proving unsustainable.

The hardest hit markets are still in recovery mode

Post-correction price evolutions in the Eurozone and the UK (2007 = 100)



Source: ECB

Germany and France

Low German interest rates, a strong labour market and excess demand for housing in urban areas should add upward pressure on housing prices.

In France, lower interest rates since mid-2015 revived mortgage credit growth which came up from 2.3% per year at the beginning of 2015 to more than 6% YoY at the end of 2017. This is supporting a stronger than expected recovery in house prices, which should accelerate from 5.1% to 7.6% and 6.5% YoY respectively in 2017 and 2018. Lower residents' taxes in 2018 could also help to give the market a boost. We expect higher interest rates to slow down the current trend only slowly in 2019 and 2020.

The Netherlands

In the Netherlands, demand for housing remains vigorous thanks to the strong growth momentum, the record high confidence and a fiscal boost to disposable income. Supply, on the other hand, is decreasing rapidly, especially in the largest cities and that's where we're seeing further steep price increases; we still expect house prices to grow by 6.5% in 2018 after 7.6% in 2017.

Belgium

In Belgium, house price growth should have rebounded slightly in 2017, at least by 2.5% after 0.8% in 2016. The fact that market prices continued to increase when the market was turning elsewhere in Europe and that low-interest rates have given it a further boost, makes the market vulnerable to higher interest rates.

This is why we expect a small price correction to materialise in 2019-2020.

Austria

In Austria, housing demand remains higher than supply on the back of ongoing favourable credit conditions and population growth, keeping house prices at elevated levels.

Portugal: Riding the growth wave

Portugal's economy will grow more than 2% this year, helped by some mild fiscal stimulus. But with lingering bank issues, a spending splurge is unlikely

Source: Shutterstock

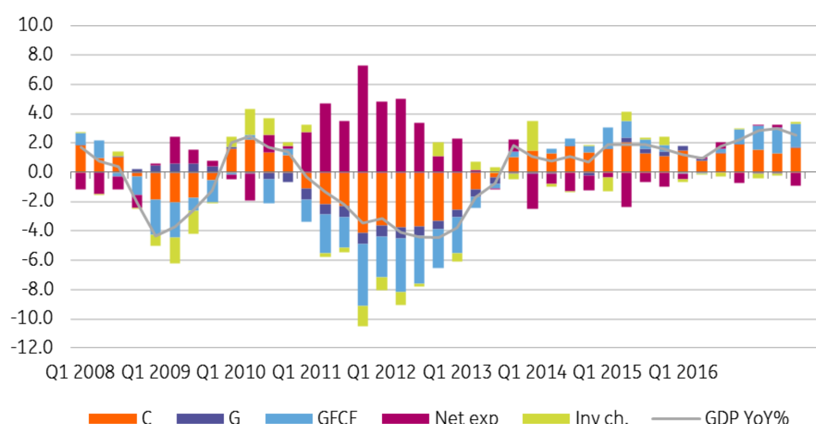
Domestic demand drives growth

The Portuguese economy is still riding the growth wave with no sign of a slowdown. In 3Q17, private consumption (which added 1.7% to growth year-over-year) and gross fixed capital formation (which contributed 1.6% YoY) were confirmed as the main drivers of annual GDP growth. Despite a substantial export drive, net exports acted as a drag on growth (-0.9% YoY).

Investment recovery and surprisingly strong employment

With capacity utilisation almost back to pre-crisis levels, a recovery in private investment was expected. The improvement in private consumption came somewhat as a surprise, however, though this was consistent with unexpectedly strong employment and recovering wage growth. Data on employment expectations suggests that this pattern might continue in the short run, but could soften over time, as the current high elasticity of employment to GDP looks unsustainable. The recent decline in productivity already signals some potential future strain in cost competitiveness.

Domestic demand traction continued unabated (contribution to YoY GDP growth)

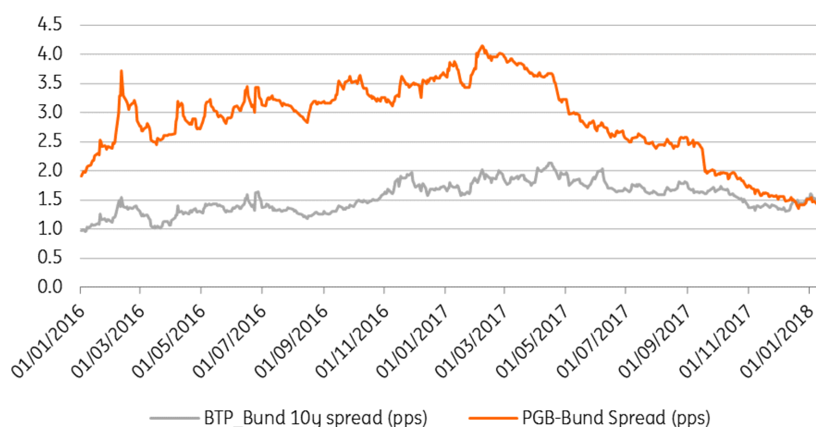


Source: Thomson Reuters

Strong growth and fiscal adjustment at the heart of a two-notch upgrade

Above-potential GDP growth had a positive impact on fiscal data, putting the 1.5% deficit-to-GDP target for 2017 well within reach. The concurrent expected decline in the debt-to-GDP ratio was an additional piece of evidence that led Fitch to upgrade Portugal by two notches in December. We expect Portugal's fiscal stance to remain mildly expansionary in 2018, which should help the economy to grow slightly more than 2% over the whole year.

Growth and adjustment mix did the magic: now 10y PGBs trade through Italian BTPs



Source: Thomson Reuters

Mild fiscal push to support GDP growth in 2018, but lingering bank issues suggest prudence

Room for laxer fiscal policy remains limited, though. Despite the ongoing deleveraging and improved financial stability, Portuguese banks' balance sheets are still burdened by a heavy load of non-performing loans. Keeping some fiscal room for a rainy day could still be prudent. With the Portuguese finance minister Mário Centeno now heading the Eurogroup, the risk of Portugal indulging in any fiscal splurge looks very small indeed.

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Belgium: Labour intensive growth

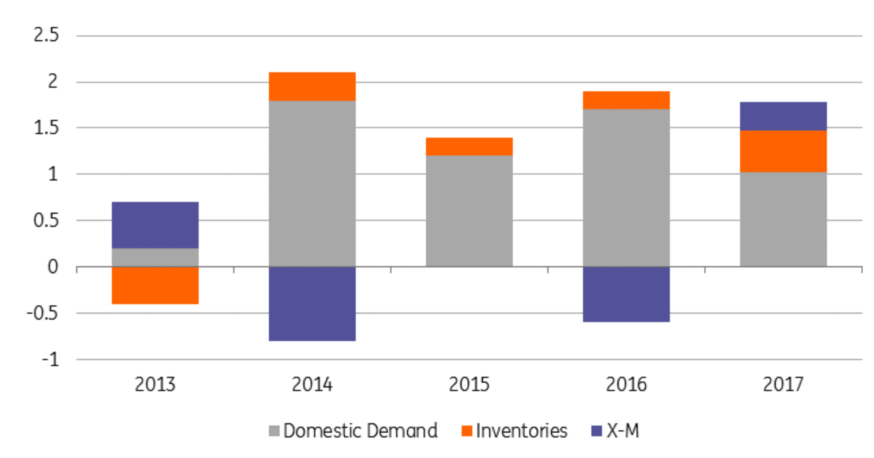
In 2018, we expect Belgian economic growth to accelerate further amid a broader Eurozone recovery

Domestic demand drives growth

With 1.8% GDP growth, 2017 can be considered a positive year for the Belgian economy. Domestic demand is mainly responsible for that figure, as it has been for the last four years. To be sure, its contribution to GDP growth was slightly below the level of previous years (Fig. 1), but we believe this was due to temporary factors: a lack of confidence amongst businesses in the middle of the year (it has been restored since then) and the fact that rising disposable income did not translate into more household spending. Fortunately, the positive contribution of both net external trade and inventories compensated for the somewhat weaker domestic demand.

This year, we expect a further acceleration of Belgian economic activity. First, domestic demand is expected to pick up speed, supported by high consumer and business confidence, but also by the delayed impact of job creation over the last two years (see below) and the expected further improvement of the labour market. Second, taking the high degree of openness of the Belgian economy into account, it is likely to benefit significantly from the strong activity in the Euro area. That's why we expect 2.1% GDP growth in 2018.

Contribution to GDP growth

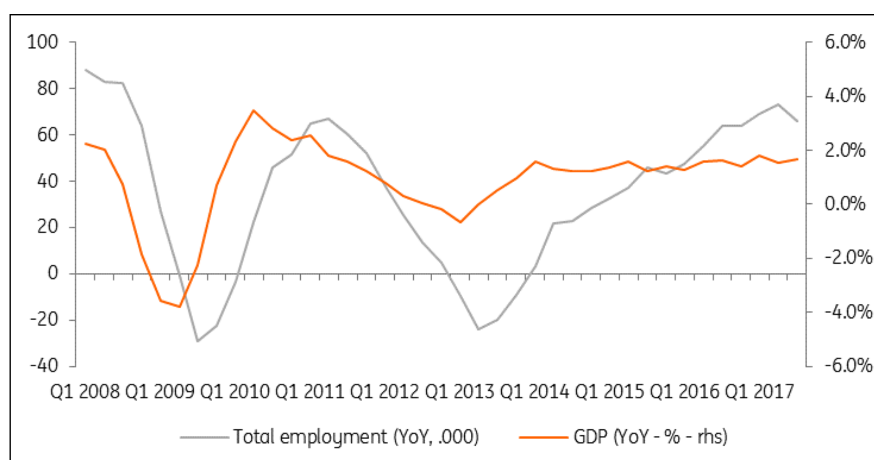


Source: Source: NBB, ING

Employment growth is strong

Looking at the job market, 2017 has been even more positive than 2016. No less than 67,000 net jobs were created last year (63,000 in 2016). More importantly, three-quarters of these jobs were created in the private sector. It is also remarkable that total employment in the industry sector stabilised in 2017 after a very long decline. In fact, current economic growth (still below its long-term average) seems to be quite labour intensive: following the historical link between economic growth and employment, GDP growth last year should have equated to about 40,000 new jobs, or only two-thirds of what was effectively created. This also allowed the unemployment rate to fall to around 7.3% in 2017.

Employment growth is stronger than expected



Source: Source: NBB, ING

Labour mismatch

Surprisingly, the biggest problem in the short term for the Belgian economy and for the labour market in particular could be the lack of qualified workers. Saying this is quite strange, knowing that more than 500,000 people are officially looking for a job, but the mismatch of qualifications is a well-known reality of the Belgian labour market. Many companies are already expressing difficulty in finding appropriately qualified jobseekers. That's also why, despite stronger economic growth, we expect job creation to be limited to a range of 40,000 to 50,000 this year. To be sure, this number is far from poor.

The current improvement of the Belgian economy is helping the government to reduce the public deficit. Better-than-expected growth combined with the measures taken by the government over the last three years, suggest the deficit fell from 2.6% in 2016 to around 1.2% last year. That said, balancing the budget will require another substantial fiscal adjustment in the years ahead, which might be difficult with general elections coming in 2019. But considering the expected nominal GDP growth and the public deficit trajectory, the debt ratio could fall below the 100% of GDP threshold in 2019.

While inflation slowed down from its 3.0% peak in March 2017 to 2.1% in December, it remains above the Eurozone average though core inflation remains more subdued. The lasting gap between Belgium and the Eurozone can probably be explained by both a lack of competition in some sectors and the wage indexation process. This process safeguards the purchasing power of households, but at the price of a certain deterioration of Belgian firms' competitiveness. Still, the negative impact should remain limited in the short run.

What then could possibly go wrong for the Belgian economy in 2018? Apart from an external shock impacting confidence, external trade or the financing of the economy, the political situation requires some attention. Indeed, local elections this year and more importantly, federal and regional elections in 2019, increase somewhat the tensions inside the current majorities (both federal and regional). The government is also under pressure by the opposition due to its management of the refugee crisis. Early elections aren't on the cards at this stage, but considering the coming deadlines, the political backdrop is likely to be shakier than it was over the last years.

The Belgian economy in a nutshell (%YoY)

	2016	2017F	2018F	2019F
GDP	1.5	1.8	2.1	1.8
Private consumption	1.7	1.2	1.8	1.6
Investment	3.6	1.0	2.5	1.0
Government consumption	0.5	0.5	0.9	1.2
Net trade contribution	-0.6	0.3	0.4	0.4
Headline CPI	2.0	2.1	1.7	1.8
Budget balance as a % of GDP	-2.6	-1.2	-0.5	-0.1
Government debt as a % of GDP	105.6	103.4	100.5	97.2

Source: Thomson Reuters, all forecasts ING estimates

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Article | 18 January 2018 Austria

Austria: It’s all systems go!

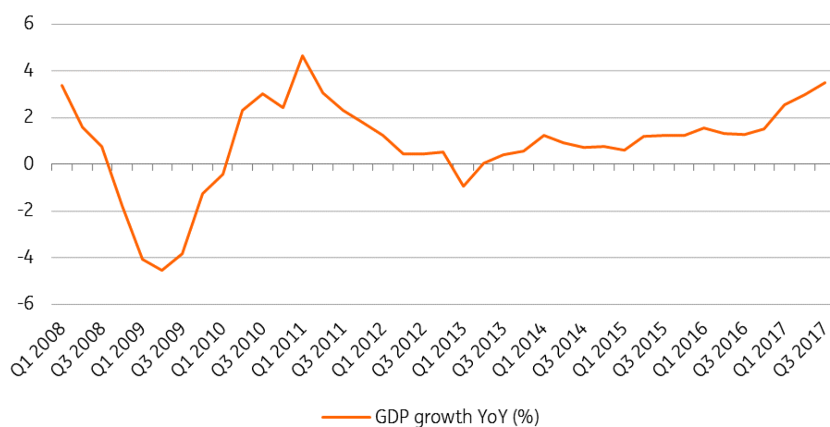
Austrian growth is robust, helped by good old-fashioned fiscal stimulus

Source: Shutterstock

Broad-based growth

All signs are pointing to an ongoing and robust Austrian growth story; the Austrian economy is likely to have hit the 3%-mark in 2017, a level last seen ten years ago. Political quarrels are largely off the table and the new government has already started working. Growth is broad-based, driven by strong domestic and foreign influences, and it's also helped by a buoyant upturn in consumption, industry and investment. And that strong momentum is set to continue throughout 2018.

Robust growth performance is set to continue



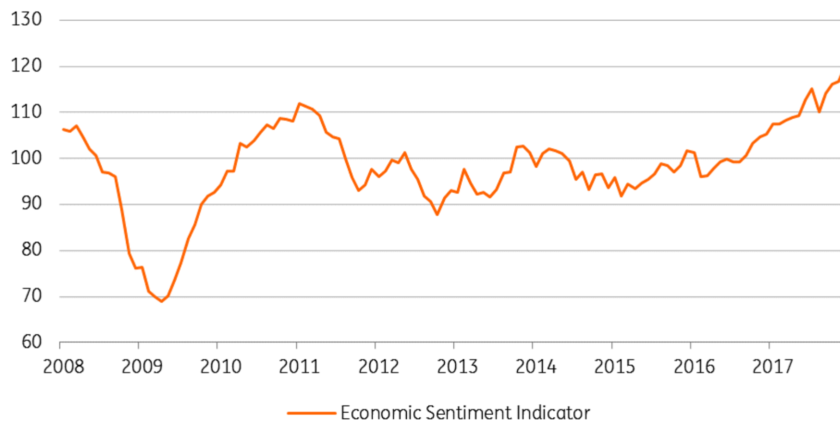
Source: Thomson Reuters

The new political landscape

Looking at the economic impact of the new Austrian government, a good old traditional fiscal stimulus is in the making. Since December the new coalition between the centre-right Austrian People's Party (ÖVP) and the far-right Freedom Party (FPÖ) is in place. Some measures for the next five years have already been announced, such as a tax bonus of 1,500 Euros per child per year and tax relief for smaller and middle-income groups, by lowering the unemployment insurance contribution.

Around 900-thousand low-income earners should benefit, gaining on average €311 a year. However, other measures such as rising working hours up to 60 hours a week, are more of a double-edged sword. That could contribute to a stronger growth performance but will also focus the discussion on social aspects of the labour market. The alignment of family allowance abroad as well as a reform of unemployment benefits still poses some questions. Nevertheless, we expect the Austrian economy to continue its current strong performance going into 2018, helped by the governmental fiscal stimulus.

Further upside for GDP growth



Source: Thomson Reuters

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Article | 18 January 2018 **Ireland**

Ireland: Brexit concerns persist

Ireland continues to perform well, but Brexit worries are cause for some concern

A sigh of relief after the first round of Brexit negotiations: a no deal scenario has thus far been avoided and the current deal on the Irish border is promising. A possible deal that there will be full alignment in terms of regulation between the EU and the UK on issues affecting the Irish border is reassuring for the Irish economy and decreases the tail risk of moderating growth because of Brexit.

It remains difficult to see how full alignment with the EU can continue if the UK starts to change regulation though, so tail risk on the partial agreement persists. The infamous Brexit phrase *"nothing is agreed until everything is agreed"* still holds and a "no deal" scenario is also still a possibility. It, therefore, remains a positive first step, but uncertainty prevails.

With that said, the Irish economy continues to perform very well despite Brexit worries. Growth in Q3 increased to 10.5% YoY, mainly on improving net exports. This will bring the annual growth rate to around 6.5% for 2017. It is not just exports that cause strength, Ireland maintains healthy consumption growth boosted by continued labour market recovery. The housing market continues to experience upward pressure on prices as demand outstrips supply in the real estate market for the moment.

The Irish economy in a nutshell (%YoY)

	2016	2017F	2018F	2019F
GDP	5.1	6.5	4.5	2.2
Private consumption	2.7	2.5	2.8	2.5
Investment	5.0	-12.3	6.5	4.1
Government consumption	5.4	2.1	2.0	2.0
Net trade contribution	1.4	9.1	1.2	0.7
Headline CPI	-0.3	0.2	1.2	1.7

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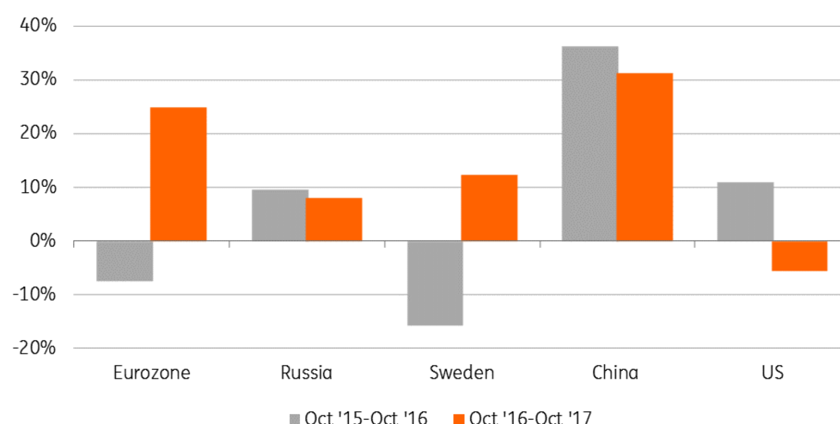
Finland: The strongest growth in a decade

The Finnish economy is powering ahead, but domestic demand could slow

The Finnish economy continues to thrive with GDP growth likely exceeding 3% in 2017. This is the strongest growth that Finland has experienced in 10 years. Growth performed particularly well thanks to strengthening exports, which are profiting from improving global growth. Exports to other Eurozone countries increased by 25% YoY in October, after a decline of about 8% in the year before. Exports to Sweden also improved markedly at 12% YoY growth in October, with exports to Russia and China increasing as well.

Improving global growth will likely contribute to continued export growth this year as all main export partners except Sweden are expected to see GDP growth maintain its current pace or even accelerate. Domestic demand could slow somewhat with wage moderation curbing consumption. The positive impact of lower wages on competitiveness is unlikely to fully offset the effects on consumption, bringing down our forecast for Finnish growth to 2% this year. The political environment is unlikely to have much of an effect this year as the presidential elections are expected to be won by the incumbent, Sauli Niinistö.

Finnish export growth



The Finnish economy in a nutshell (%YoY)

	2016	2017F	2018F	2019F
GDP	1.9	3.1	2.6	2.3
Private consumption	1.8	2.0	1.6	1.5
Investment	7.2	6.9	4.4	3.0
Government consumption	1.2	0.7	0.3	0.1
Net trade contribution	-1.2	0.8	0.6	0.7
Headline CPI	0.5	0.9	1.1	1.5

Source: Macrobond, all forecasts ING estimates

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