Eurozone Quarterly: Tiptoeing around the ‘r’ word

Trade wars uncertainty, strong euro exchange rate in effective terms, a slowdown in the emerging world, uncertain Brexit outlook, Italy's budget saga and the social unrest in France all contributed to the slowdown in the Eurozone economy in 2018. While Germany seems to have just about avoided a technical recession, things still look pretty grim in Italy

THINK Economic and Financial Analysis

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Contents

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Eurozone: The best is now (firmly) behind us

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Peak growth is now behind us and while there are still positive drivers that make it too soon to call the end of the expansion, growth in 2019 is likely to come out much lower than last year. We forecast 1.4% GDP growth in 2019 and 1.3% in 2020 but the risks are skewed to the downside. In these circumstances, the probability of an ECB rate hike is melting away

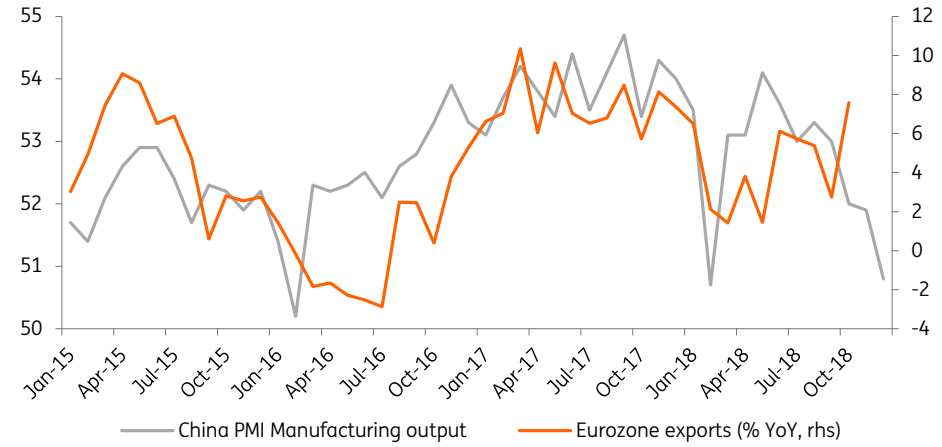
2018 ended on a soft note

After a strong start, the eurozone economy lost momentum throughout 2018. To be fair, with capacity constraints showing up, the eurozone could simply not maintain a growth pace above 2%. But other headwinds explain the growth deceleration. The uncertainty provoked by the trade wars, the strong euro exchange rate in effective terms, the slowdown in the emerging world, the uncertain Brexit outlook and the clash between Italy and the European Commission all contributed to a loss of confidence. Not to mention some very specific problems in the German car industry that resulted in a GDP contraction in the third quarter with only limited improvement in the fourth quarter.

Germany seems to have avoided a technical recession, but it still looks possible in Italy

Sentiment indicators weakened further; the European Commission's economic sentiment indicator fell back from 109.5 in November to 107.3 in December 2018. The social unrest in France, initiated by the so-called 'yellow vests,' has probably shaved at least 0.2 percentage points off French 4Q GDP growth. Because of that, we expect eurozone 4Q GDP growth to be only 0.2% on a non-annualised basis, and even that might turn out to be too optimistic. While Germany seems to have avoided a technical recession, it still looks possible in Italy.

Eurozone exports might be hurt by Chinese slowdown



Source: Thomson Reuters Datastream

Consumer to the rescue?

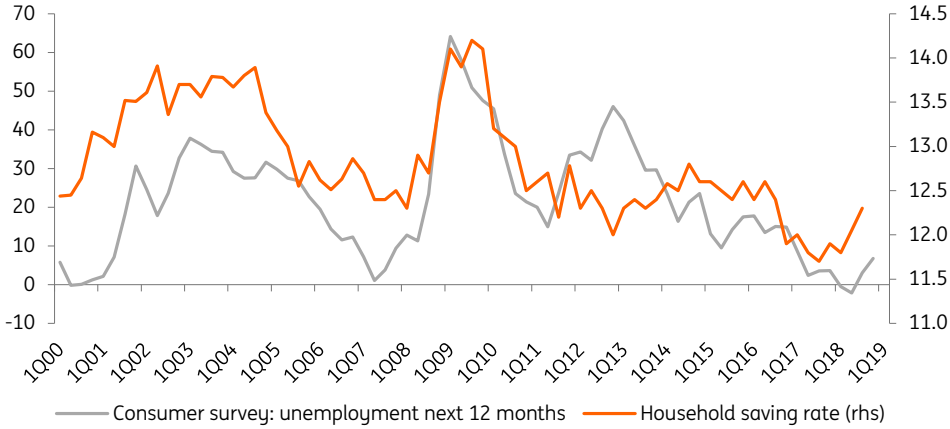
Forward-looking indicators do not bode well for the first quarter either. The assessment of order books in manufacturing fell back significantly in December, while expected demand in the services sector also weakened. With export growth unlikely to accelerate much in the coming months, the first quarter is unlikely to see a significant pick-up, as demand from emerging countries, and especially from China, is not showing signs of recovery for the time being. While financing costs are still attractive (though credit spreads have been increasing throughout 2018), the decline in the profit share of non-financial corporations could be a harbinger of a more cautious investment stance in 2019.

However, as an antidote against too much pessimism, there is still the labour market. In November, the unemployment rate shrank to 7.9%, the lowest level in a decade. As a consequence, wages growth is gaining traction. Combined with far lower energy prices, this should boost purchasing power and consumption in the first half of the year.

The decline in the profit share of non-financial corporations could be a harbinger of a more cautious investment stance in 2019

On top of that, there is some fiscal loosening in the three biggest member states in the offing. The last retail sales figures showed a healthy 0.6% increase in November after an already strong October. But let's not get carried away either. Consumer confidence has been falling lately. More specifically, there has been a significant increase in unemployment expectations since the summer months, which typically goes hand in hand with a rising saving rate. So, some of the increase in disposable income is not going to be translated into more consumption.

Saving rate is likely to increase



Source: Thomson Reuters Datastream

Politics remain a headache

Then there are potential political shocks. The Italian problem seems to be resolved for now as the Italian government and the European Commission reached a compromise, allowing for a budget deficit of 2.04% in 2019. The 'excessive deficit procedure' will be shelved for the time being, causing some relief on the Italian bond market, but that doesn't mean that political risk within the eurozone has abated.

Politicians are starting to prepare for the European Parliamentary elections, with Matteo Salvini seeking alliances within Europe to form a big eurosceptic block within the European Parliament. Admittedly, while this block will probably grow in importance, it would still be a minority. That said, the advent of more nationalist voices could make mainstream politicians more reluctant to pursue a policy of further European integration. That is troublesome since eurozone reform is far from completed, making a more significant economic downturn potentially an existential threat for the single currency.

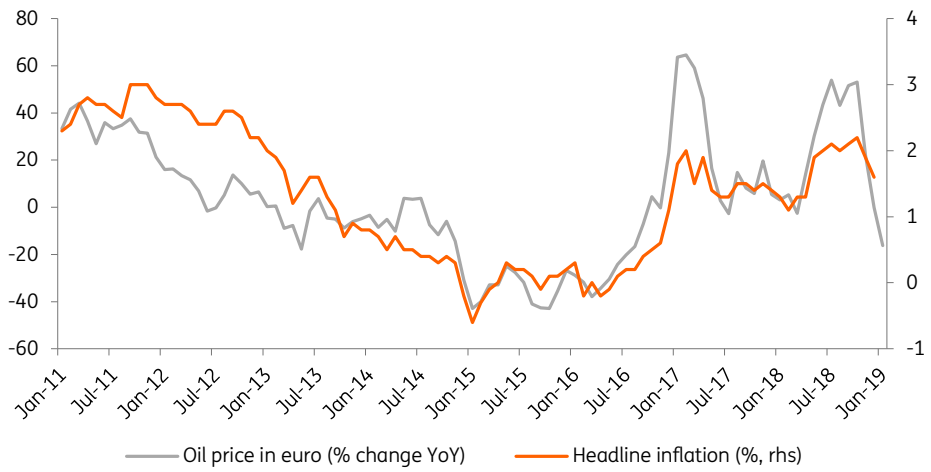
We forecast GDP growth of 1.4% in 2019 and 1.3% in 2020, but risks are clearly tilted to the downside

On the trade front, there is still the risk that President Trump would want to impose import tariffs on European cars (the US Commerce Department is expected to issue a report on the strategic character of the automobile sector for the US economy by 17 February).

Lastly, the Brexit uncertainty hasn't gone away. In the case of a hard Brexit, a temporary hit to exports to the UK seems unavoidable, something that could tilt the whole of the eurozone into a technical recession. Our base case doesn't pencil in a hard Brexit, and we now think that the UK is almost certainly going to apply for an extension to the two-year Article 50 negotiating period, to get things sorted out.

All in all, we continue to forecast 1.4% GDP growth in 2019 and 1.3% in 2020, but the risks are clearly tilted to the downside.

Lower oil price pushes down inflation



Source: Thomson Reuters Datastream

Money market rates to remain negative

It's hardly surprising we are convinced the ECB's growth forecasts (1.7% for both 2019 and 2020) are way too optimistic. To be honest, there is already a feeling that members of the Governing Council are well aware of the rosy outlook as the minutes of the December meeting said: the balance of risks was moving to the downside, but the ECB refrained from going further than that. Inflation might also surprise to the downside. The strong fall in energy prices will have a downward impact on headline inflation in the

coming months. And while higher wages could boost core inflation, we think tighter profit margins will partially neutralise this impact. We simply cannot see how companies will be able to pass on higher costs to consumers in the wake of slowing demand and a still strong euro in effective terms.

In these circumstances, we see little incentive for the ECB to tighten monetary policy. We still think there could be a small hike in the deposit rate, say 15 to 20 basis points, in the fourth quarter of 2019 to start shelving the second deflation-fighting policy instrument, but this is far from a given.

It's hardly surprising we are convinced the ECB's growth forecasts are too optimistic. There is already a sense that members of the Governing Council are well aware of the rosy outlook

In any case, we don't see any refi rate hike over the forecast horizon. This essentially means that money market rates will probably remain negative throughout 2020; a reason why bond yields are unlikely to see strong upward pressure for some time to come. As the unwinding of the very cheap TLTRO funding might make bank credit more expensive over the coming years, there is a rising probability that the ECB will consider another round of long-term funding for the banks. In the minutes of the last meeting, suggestions were made to revisit the contribution of targeted longer-term refinancing operations to the monetary policy stance.

When the 'relevant committees' are asked to study something, we know something is brewing.

The Eurozone economy in a nutshell (% YoY)

	2017	2018F	2019F	2020F
GDP	2.5	1.9	1.4	1.3
Private consumption	1.7	1.5	1.5	1.4
Investment	2.9	3.1	2.2	1.0
Government consumption	1.7	1.1	1.3	1.4
Net trade contribution	0.8	0.3	-0.1	0.0
Headline CPI	1.4	1.7	1.5	1.7
Budget balance (% of GDP)	-0.9	-0.6	-0.9	-0.8
Refi rate (eop)	0.00	0.00	0.00	0.00
10yr Bund (eop)	0.42	0.24	0.60	0.50

Source: Thomson Reuters, all forecasts ING estimates

Germany: Maybe it's time (to let the old ways die)

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From stellar growth to the brink of a recession within less than a year. Germany needs more than good luck to return to the European pole position

Only one year ago, German growth forecasts were being revised upwards almost by the day. No end to the ten-year supercycle was in sight. Instead, another year of stellar performance was on the cards, driven by strong domestic demand and rebounding exports on the back of a weak euro.

Now, it seems as if Germany's growth prospects are diminishing by the day. A disappointing second half of 2018, bringing the economy close to a technical recession, has returned swan songs on the German Wirtschaftswunder, or economic miracle if you prefer. The truth, as so often in Europe, is probably somewhere in the middle.

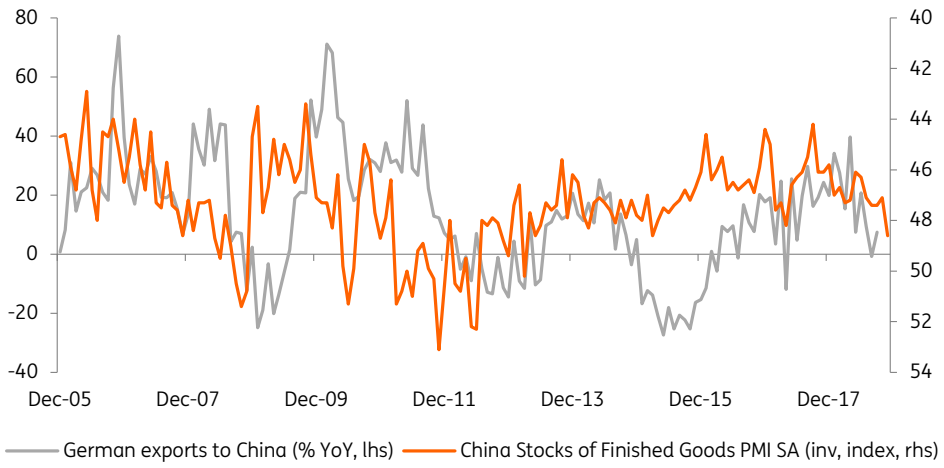
Cars, cars, cars

The main reason for the unexpected cooling of the economy in the second half of 2018 is cars. Missed deadlines for the admission of new emission standards led to an enormous inventory build-up in the second and third quarter of the year and, consequently, very weak sales and now production performances. Also, the announced ban on cars with old diesel engines for several German cities has not only weakened car sales but also led to precautionary savings by households over the summer months. Lastly, still remotely related to cars, the drop in global oil prices did not initially bring relief to German customers as cheaper oil did not reach petrol stations or heating oil companies due to low water levels in many German rivers.

Industrial production has been treading water since 2017

And even though the automotive industry is key for the entire economy with a direct and indirect impact on up to 10% of German employment, there is more to the industrial slowdown than simply cars. In fact, the last significant quarterly surge in industrial production dates back to the fourth quarter of 2017. Since then, industrial production has been treading water, first on the back of supply-side constraints and more recently on the back of weakening demand.

Suffering from the Chinese slowdown



Source: Bloomberg

Still, the automotive industry illustrates the wider problem in the German economy: the slowdown is a combination of one-off and structural factors. Just think of the harsh winter weather, unusually high sick leave due to the flu, the timing of Easter and holiday, strikes and, more recently, low water levels in main rivers, but also of the lack of investment in digital and traditional infrastructure, delays of railways and airlines, and barely any significant new structural reforms for the past ten years. The future path of the economy clearly depends on which of the factors weighs more. If it's one-off factors, then a rebound of the entire economy looks plausible. If it's structural factors, then the German economy should be prepared for a long period of underperformance.

Politics are changing swiftly

In the middle of this new economic uncertainty, politics are also changing swiftly. Angela Merkel has put an expiration date to her time in office, resigning as party chairwoman last December and by announcing that she would not run for a fifth term in office at the next elections (officially scheduled for 2021). While headlines were dominated by the leadership race in Merkel's CDU, the more crucial factor in the question of whether or not the current German government coalition will make it until 2021 is actually the SPD. As in many other European social-democratic parties, the SPD has been suffering severe losses in almost every election. In our view, the SPD's results at the European Elections will be key for the continuation of the current German government. It remains one of this year's main political risks that the SPD steps out of the government towards the end of the year. In such a scenario, a minority government under Merkel or new elections (without Merkel) are our most probable scenarios.

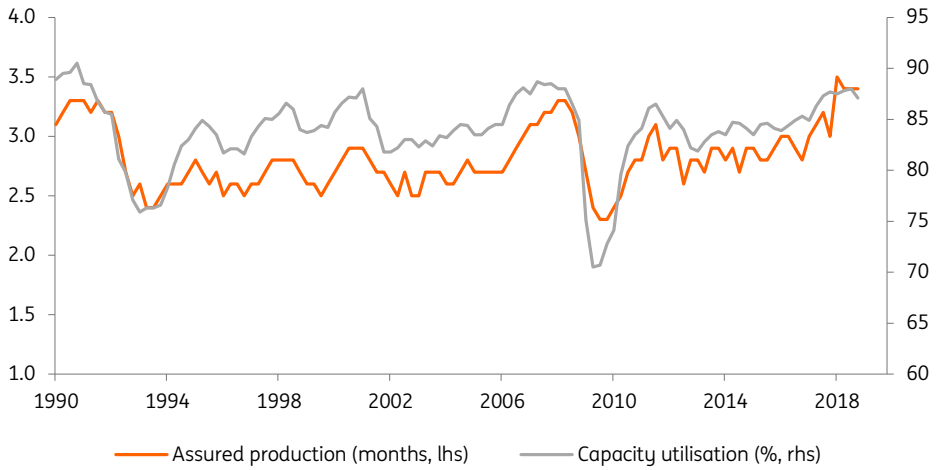
The future path of the economy could have a significant impact on politics. In the case of a severe slowdown, we would expect the government to decide on fiscal stimulus, putting aside political and inner party controversies. Here, the SPD could, despite further lost elections, decide to stay within the government. A mild slowdown without any significant dents in the labour market would probably do little to divert inner-party considerations.

Technical recession avoided, rebound in the cards?

Latest data from the statistical agency suggest that the economy has just avoided a technical recession. With an annual growth rate of 1.5% in 2018, the economy should have grown by 0.1-0.2% QoQ in the fourth quarter. Looking ahead, there are still plenty of reasons to remain optimistic: despite a recent deflation in new orders, order books remain richly filled and companies still report assured production close to record highs, and while capacity utilisation has dropped to its lowest level since the third quarter of

2017, the lack of equipment is a more limiting factor to production than the lack of skilled workers.

Supply side constraints still bode well for investment



Source: Thomson Reuters

In addition to this, the recent pick-up in orders in the automotive industry and favourable financing conditions across the economy also bode well for at least solid industrial and investment activity in 2019. Needless to say, in the short run the biggest risk to this optimistic outlook is a disorderly Brexit which would come at a most inconvenient time for the German economy.

Lady Gaga to the rescue

Admittedly, this rebound is driven mainly by another extension of a mature cycle. To tackle the structural nature of the recent slowdown, the German economy clearly needs a new investment initiative combined with structural reforms. To say it once again with Lady Gaga and Bradley Cooper: the German economy has not reached the shallow, maybe it's time to let the old ways die... if it wants to be born as the new growth star of Europe.

The German economy in a nutshell (% YoY)

	2017	2018F	2019F	2020F
GDP	2.2	1.5	1.7	2.1
Private consumption	2.0	1.1	1.4	1.7
Investment	3.6	3.2	3.7	3.8
Government consumption	1.6	0.9	1.7	1.6
Net trade contribution	0.3	-0.4	-0.2	0.2
Headline CPI	1.7	1.9	1.6	1.8
Unemployment rate (%)	4.1	3.5	3.3	3.1
Budget balance as % of GDP	1.1	1.9	1.0	0.7
Government debt as % of GDP	64.9	60.5	57.2	56.6

Source: Thomson Reuters, all forecasts ING estimates

France: Yellow Fever

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2018 ended with unprecedented grassroot protests throughout France, which have affected the main growth indicators. Consumer confidence was particularly hit in 4Q18. The impact of this domestic crisis will be felt across all sectors. We believe there'll be an uptick in the coming months, but see GDP growth limited to 1.3% this year

1.3% French GDP growth
ING forecast for 2019 and 2020

2018: the lost year

The second half of 2018 has been a disappointment on many economic and political fronts in France. The President's approval rating dropped from 42% in the first half of the year to a mere 23% in December (Source: Elabe) on the back of the 'yellow vest' crisis which paralysed the country during major shopping weekends at year end, hurting growth in the worst manner (see below). The crisis interrupted the debates on crucial reforms (institutional, pensions, unemployment rights). Now that the government has put in place some measures to support the still ongoing purchasing power growth and to organise a national debate, the polls seem to be turning. The President's approval rating slightly rebounded by 2 percentage points in January, to 25%, which is as low as François Hollande's rating after his first 21 months in office. It is still very fragile though, and very dependent on the success of the national debate the government is currently putting in place.

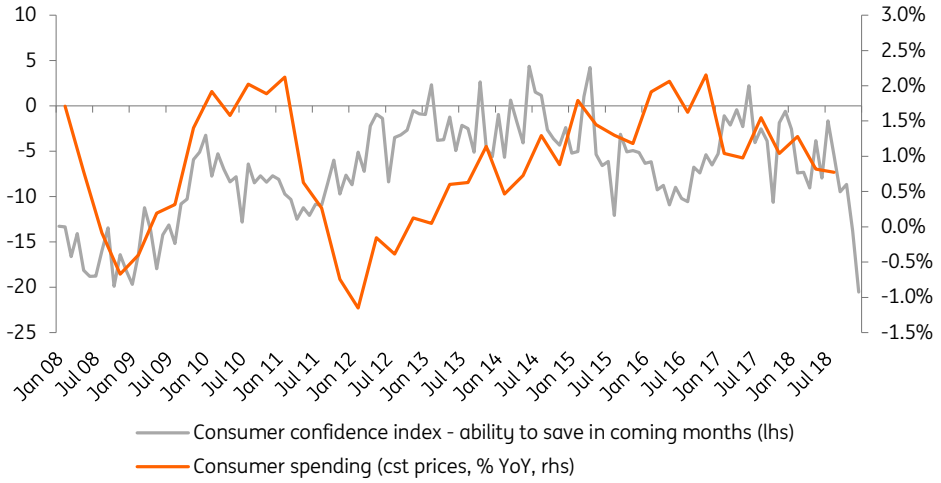
This national debate could have virtues though. The formula led to success in the past; spending months on the road to listen to the French in 2016 allowed Mr Macron to establish the political programme that brought him to power. The national debate could be a way to validate the main reform needs he identified two years ago, notably for the pension system. We believe that it will be tough and that French institutions, in general, will continue to be under solid pressure but that there is no other way to regain support. Moreover, it will also be a platform for the European Parliament elections at a time when campaigning 'as usual' looks difficult for traditional parties given the high level of political defiance among the French. We doubt that it will be enough to avoid another victory by the far-right Rassemblement National in May's European elections but it could

help the President's party, LREM, to have a presence on the European stage, only two years after its foundation in April 2016.

2018 will end on a humbling note

The window for reforms is closing fast though: the current economic slowdown, exacerbated by the 'yellow vest' crisis, will make reforms increasingly difficult in 2019. Indeed, on the economic front, the rebound that was expected in the second half of 2018 never really happened, with the fourth quarter being particularly affected by the 'yellow vest' crisis, while the third only showed half of the expected rebound, with GDP growing by 0.3% QoQ. Given that the first half of the year had already been slowed down by weeks of strikes that notably affected the transport sector in April and May, 2018 will end on a humbling note. The potential for a 2.0% GDP growth, which was in place at the beginning of the year, vanished and has turned into 1.5% at best. Given the weaker European economic context that is expected in 2019 and 2020, we believe GDP growth will return to potential, or 1.3% YoY, in both years. If domestic demand should recover slightly, it is indeed likely that external trade will weigh on growth (as it usually does) as the euro catches up some ground against the US dollar over the next two years and less dynamic world trade affects demand for French exports. Note that on this front, all forecasts are made under a 'no hard Brexit' assumption.

French consumer confidence and spending



Source: Thomson Reuters

Domestic demand starts 2019 with high anxiety

At 86.7 in December, the main consumer confidence index reached its lowest level since October 2014. The large drop in purchasing intentions that was measured in November continued in December, with intentions reaching their lowest level since June 2013. The second largest change in the survey was measured in households' sentiment in relation their ability to save, which had been restored in the first half of 2018. Lastly, despite the fact that unemployment continued to decline in recent months, fears of unemployment – which made a two-year jump back in time in November – continued to increase in December, although the rise was limited.

The survey shows an abnormal level of anxiety among French consumers

The survey therefore shows an abnormal level of anxiety among French consumers: their sentiment about their ability to save is worse now than at any point of 2008 and 2009, while the current economic slowdown has nothing in common with what was seen at that time and despite the fact that purchasing power per household has increased by 1.4% in

2018 (Source: Bank of France) after a cumulated 3.7% between 2013 and 2017, which was admittedly weak (two times slower than real GDP).

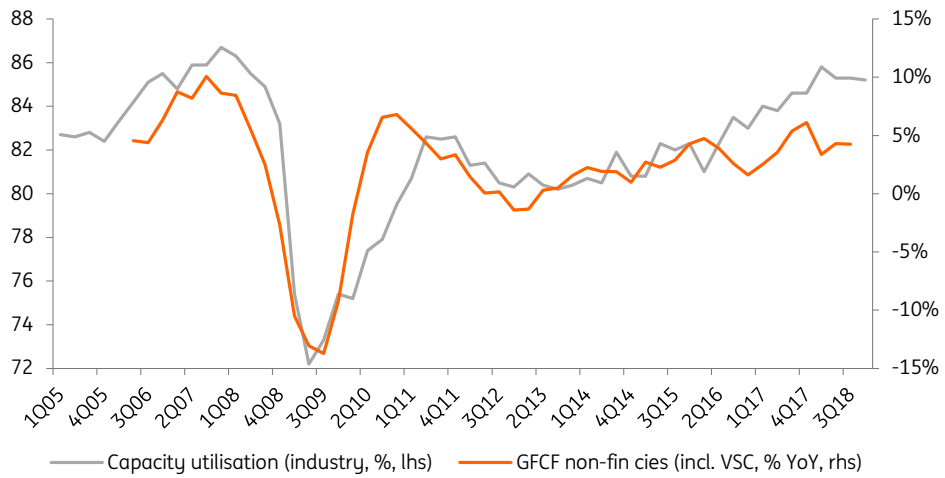
However, this high level of anxiety will have a lasting impact on consumption long after the short-term shock of the 'yellow vest' crisis is over. Consumer spending was already contracting in November and purchasing intentions in December clearly show another negative month. Private consumption could, therefore, contract slightly in 4Q18, leading in 2018 to the weakest private consumption growth since 2014, at 0.9%. In 2019, private consumption should catch up on the back of lower energy prices, lower unemployment and higher purchasing power (the Bank of France expects it to rebound by 1.8% this year). However, we expect the rebound to be limited by the current level of anxiety, which we believe will feed saving behaviours rather than consumption in the coming months. We, therefore, revise our private consumption growth forecast from 1.5% to 1.1% this year while unemployment should drop to 8.5% in the course of this year. 2019 should indeed be – with 2018 – the second year posting a decline in the unemployed population (all categories included, so outside the subsidised jobs effect) since the beginning of the crisis.

The main strengths come from business investments

The main strengths we are still seeing at the moment in domestic demand come from the current level of business investments. Industrial surveys are showing that despite a decline in the economic outlook, capacity utilisation did not decline significantly in the fourth quarter while export order books remain well filled. The catching-up effect in the automobile industry should also support manufacturing in 2019: even if we do not think that car sales will recover to their summer 2018 level anytime soon as diesel car prices are durably affected by the new European norms, it does not mean that the situation cannot improve at all. Corporate investment growth should, therefore, decelerate only slightly in 2019, to 3.5%. Household investments should, on the contrary, remain subdued after a very weak second semester of 2018 despite low-interest rates. This is why we expect a deceleration in investment growth from 2.8% to 2.5% between 2018 and 2019, and to 2.2% in 2020.

Lastly, global trade growth should decelerate again in 2019 on the back of weaker economic trends in the US and China and a peak in German exports. French net exports, which benefited in 2018 from the weakness of domestic demand for imports and a relatively strong external demand despite the euro strength (outside the EUR/USD story, the effective euro exchange rate reached a peak this year), should again weigh on growth in 2019 and 2020.

Capacity utilisation remained elevated in 4Q18 (at 85.2%)



Source: Thomson Reuters

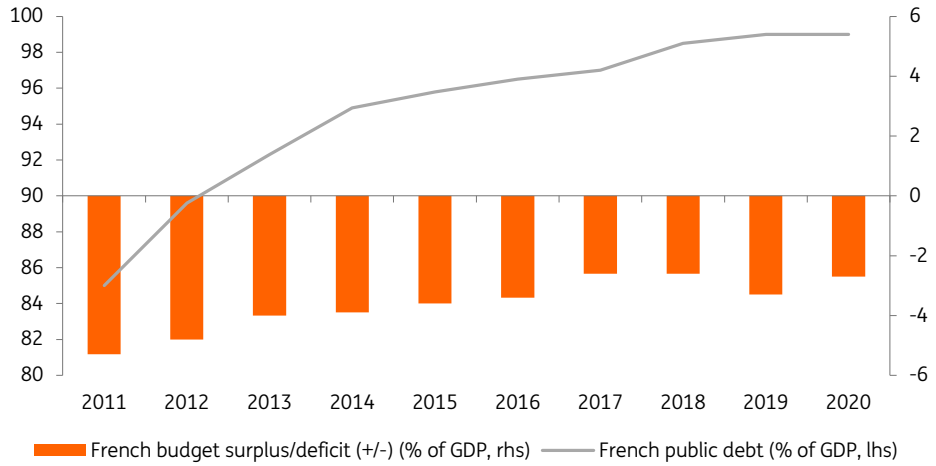
An ill-timed budget impact

Adding the effects of lower GDP growth to a higher deficit in 2019, it is unlikely that France will have a deficit below 3% in 2019. In fact, the 2019 budget was already impacted by the recovery of SNCF's debt and the transformation of tax credits for competitiveness into lower charges: it was already forecast at 2.9%, close to the limit. This should be exceeded, the deficit reaching 3.3% and the debt nearing 100%. Nevertheless, we believe that the downward trajectory will be maintained. In the coming months, the government should detail corrective measures aimed at reducing public expenditure. We, therefore, maintain a deficit forecast of less than 3% in 2020, or 2.9% instead of the previously expected 2.6%.

The rest of Europe may not be ready to support risk sharing or tax transfers

If the shock were to be temporary, the least we can say is that it is ill-timed at the European level. Italy has indeed been forced to review its budget to avoid a new excessive deficit procedure, a procedure that France itself officially ended only last June. Both situations are, however, far from comparable since even the blip of 2019 does not put into question the trajectory of the French public debt, which should decrease in the coming years. If we think that the debate around a new Excessive Deficit Procedure for France is largely exaggerated, it remains that this makes France's position on eurozone reforms more difficult to hold. So long as President Macron shows that France cannot be reformed, the rest of Europe, especially in the north, will not be ready to support risk sharing or tax transfers among eurozone members. The small steps that were endorsed in December by the European Council in terms of the EU budget and the Banking Union, and which acknowledged some French demands, may, therefore, be the last for a while.

French budget surplus and public debt



Source: Thomson Reuters

French economy in a nutshell (% YoY)

	2017	2018F	2019F	2020F
GDP	2.3	1.5	1.3	1.3
Private consumption	1.1	0.8	1.1	1.4
Investment	4.7	2.8	2.5	2.2
Government consumption	1.4	1.0	1.2	1.2
Net trade contribution	0.1	0.6	-0.1	-0.4
Headline CPI	1.0	1.9	1.5	1.8
Unemployment rate	9.4	9.1	8.6	8.6
Budget balance as % of GDP	-2.6	-2.6	-3.3	-2.7
Government debt as % of GDP	97.0	98.5	99.0	99.0

Source: Thomson Reuters; all forecasts ING estimates. Unemployment rates according to ILO definition

Italy: Still looking vulnerable

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A likely technical recession in 4Q18 will be followed by highly uncertain developments, with the European election campaign possibly impacting the domestic political debate. Over 2H19 handouts foreseen by the budget might help support consumption, but will not prevent a soft annual GDP growth reading

PM Conte managed to reach a compromise with the EU on the 2019 budget

The budget-challenge-opposing Italian populist government and the EU Commission ended up with a compromise. After defining its 2.4% deficit call as undisputable, the Italian government bowed to Brussels' requests and reduced the deficit target to 2% of GDP (or, to be precise, to 2.04% to make it appear similar to the original proposal), while trimming the untenable original growth forecast for 2019 to a more reasonable yet still extremely optimistic 1%.

In the process, PM Conte, who had started his adventure in government with a notarial role, settled into the driving seat and played a central role in negotiations with the EU Commission. Political leaders Di Maio and Salvini, for their part, tried to ring-fence their respective strongholds, the (temporary) loosening of pension rules and the citizenship income from the tightened constraints of fiscal discipline.

After a domestic-demand driven halt in 3Q18...

Economic growth continued to soften. Having expanded by 0.2% QoQ in 2Q18, Italian GDP contracted by 0.1% QoQ (+0.7% YoY) in 3Q18, on the back of softer domestic demand. Worryingly, but to some extent unsurprisingly, the main drag came from private investments, possibly affected by the poor visibility regarding the true economic and fiscal strategy of the unprecedented League/5SM government. The soft reading in private consumption was somehow more surprising when considering the consolidation of employment gains over the summer and growing evidence of tentative wage pressure. Net exports provided a marginally positive contribution to quarterly growth, thanks to a decent export performance, which materialised in spite of an already deteriorating international backdrop.

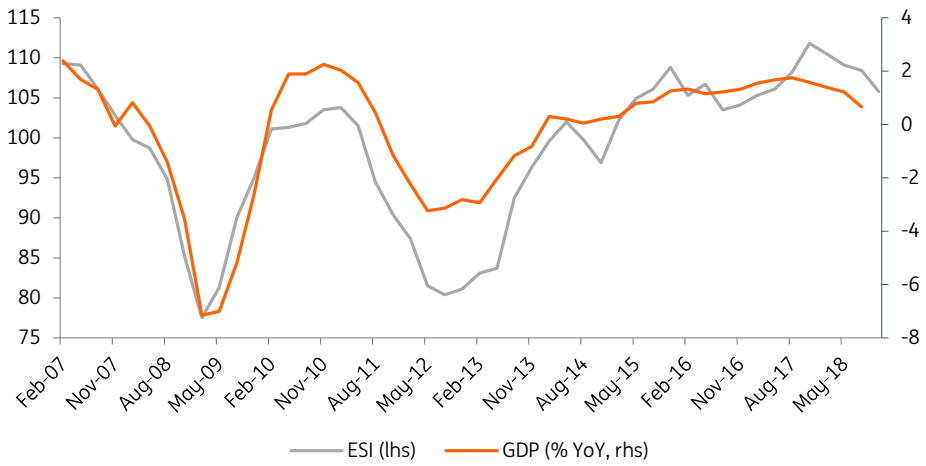
...the Italian economy could enter technical recession in 4Q18

Data evidence for 4Q18 points to a substantial risk of a technical recession. Istat confidence data has fallen further in the quarter, with the service sector finally joining manufacturing in the downturn as domestic demand concerns mounted. The PMI

siblings have shown only partially similar patterns, with the manufacturing index stuck in contraction territory and the services measure managing instead to reach marginally back above the 50 threshold in November and December.

While confidence in the retail sector recently rebounded a bit, this was not matched by consumer confidence, which dropped further albeit remaining at relatively high levels. The net impact on household consumption is uncertain, but a modest improvement in consumption data in 4Q18 cannot be ruled out. Given continuous tensions in the international backdrop, we doubt that net exports were able to propel quarterly growth in 4Q18. Poor November industrial production data, with a widespread contraction, contributed to tilt the balance of risks. On past form, both the ESI and the computed composite PMI indicator for 4Q18 are compatible with another 0.1% QoQ GDP contraction in 4Q18, implying a technical recession, which is now our base case assumption.

Business confidence indicators consistent with technical recession



Source: Datastream, ING

Private consumption possibly more resilient in the short run

The big question remains whether the current soft patch will turn into a nastier fully-fledged recession over the course of 2019. We do not buy into this story yet, as some of the pending uncertainties weighing on 2019 might hide positive surprises. Certainly, the chance of a swift reversal of fortunes for the Italian economy over 1Q19 look limited. The fundamentally more sound demand component looks set to be private consumption, supported by employment, which has stabilised at around pre-crisis highs, and by a likely recovery in real disposable income related to the energy-price-driven drop in headline inflation.

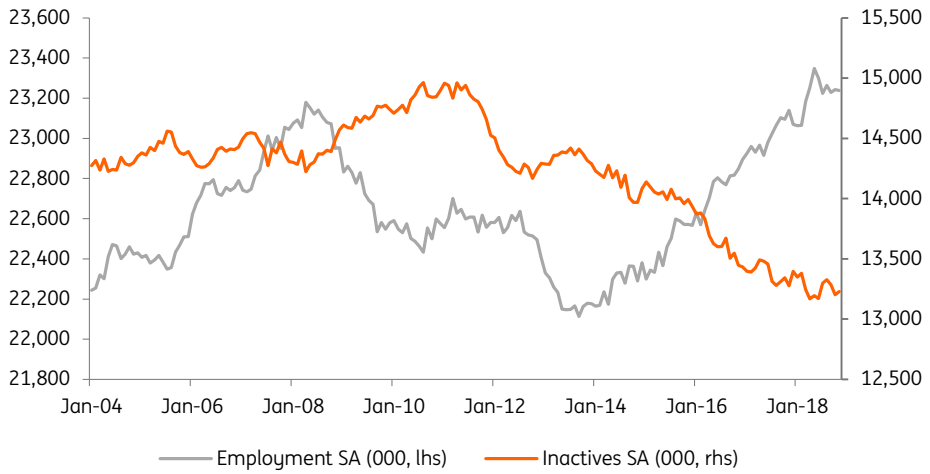
Citizenship income handouts to support consumption over 2H19

Execution of the 2019 budget could potentially have an impact on growth prospects, particularly in 2H19. The core measures proposed by the populist government alliance, to be finalised soon in a government decree, could on paper be marginally growth-supportive, at least in the short run. More specifically, the introduction of a citizenship income handout will at first represent an injection of fresh cash in the pockets of the poorest brackets of the population.

We are far more sceptical about its effectiveness in pushing up the activity rate on a sustainable basis, as this will crucially hinge on the effectiveness of employment centres, which is far from a given. Furthermore, a concurrent incentive for businesses willing to hire people under the programme might not be enough to convince employers to staff up in an uncertain demand environment, particularly in southern regions. Even harder to work out is just how expansionary for the economy the introduction of early

retirement schemes for people who are at least 62 years old and who have a contribution history of at least 38 years could be; the timing and the extent of the substitution rate of such retirees with fresh new workers will be highly uncertain.

Employment, above pre-crisis levels, remains supportive for consumption



Source: Thomson Reuters Datastream

Politics back to the fore, with the risk of a government crisis higher after the European vote

Politics might also prove a relevant driving factor over 2019. The League and 5SM parties will have to play two roles at a time: that of a reliable partner in the government alliance and that of a stand-alone competitor in the all-important European Parliament election race (to be run under proportional rules). Playing both roles is likely to increase the probability of occasional clashes between the two. Episodes even since the beginning of 2019 on issues such as migrants (a stronghold of the League) and big infrastructure projects (a stronghold of 5SM) provide evidence of how the domestic political environment might look over the next 3-4 months under campaign polarisation spells.

Does this mean that the coalition is set to collapse soon? Not necessarily, in our view, at least not before the European Parliament vote has taken place. It's well known that a government crisis would not necessarily mean imminent elections; Salvini could prefer to cash-in his huge potential support in the European Parliament election and leverage on it afterwards to twist the balance of power within the government while keeping the option open for a new right-centre alliance should domestic elections materialise. Latest opinion polls have 5SM at c.27% of the vote (down some 5-6ppt from the 4 March 2018 result) and the League at c.31.5% of the vote (up some 14ppt from the 4 March 2018 result).

The Italian economy in a nutshell (% YoY)

	2017	2018F	2019F	2020F
GDP	1.6	0.9	0.5	0.6
Private consumption	1.5	0.6	0.6	0.8
Investment	4.4	4.0	1.0	1.5
Government consumption	-0.1	0.1	0.8	1.0
Net trade contribution	0.3	-0.3	-0.1	-0.2
Headline CPI	1.3	1.2	1.0	1.4
Unemployment rate (%)	11.3	10.6	10.6	10.4
Budget balance as a % of GDP	-2.4	-1.9	-2.4	-2.2
Government debt as a % of GDP	131.2	131.3	132.0	132.0

Source: Thomson Reuters, all forecasts ING estimates

The Netherlands: Not done growing yet

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A less rosy global growth picture, fewer housing market transactions and increasing labour market tightness cause Dutch growth to fall to 2.0% in 2019. Domestic momentum remains strong enough to handle a small external shock, but major foreign risks remain. Wage growth finally increased. Inflation rises primarily due to higher VAT and energy taxes.

The Netherlands not immune to (global) slowdown; gradual return to potential growth rate

See here for our assessment of 3Q18 GDP figures

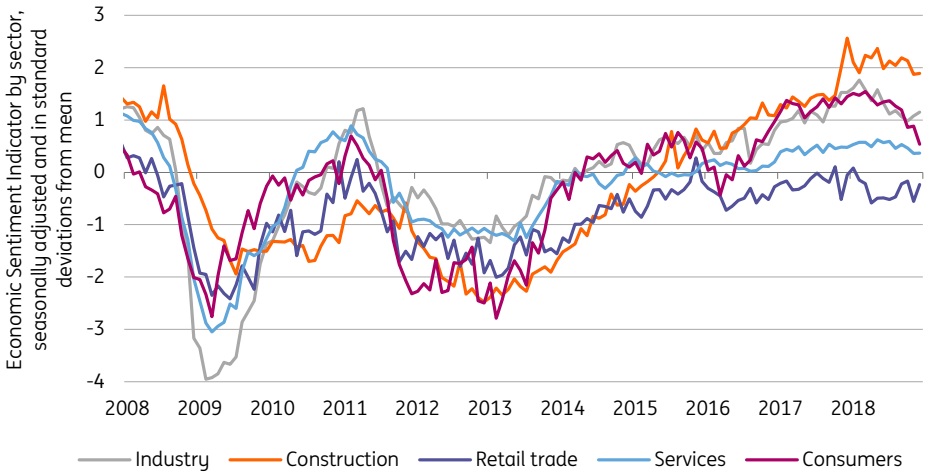
Dutch GDP growth fell from a strong 0.8% QoQ in 2Q18 to a meagre 0.2% QoQ in 3Q18 while a wide range of survey indicators have clearly come off their peak in 2018. Yet, based on our estimate that the output gap is only mildly positive, the Dutch economy is still growing. Domestic demand continues to be self-sustaining, after eighteen quarters of positive growth in a row. We expect growth to have rebounded somewhat in 4Q18 and forecast it to slow from an annual figure of 2.6% in 2018 to 2.0% in 2019. In 2020, we forecast a return to the potential growth rate of around 1.7%.

2.0% Netherlands GDP growth
ING forecast for 2019

Soft indicators fell significantly, but still point to decent growth ahead

The mood of consumers and industry has turned less optimistic, for industry in relation to foreign activity in particular. Nevertheless, sentiment in general is still more positive than the historical average. Commercial services seem relatively steady in their judgement of the economic situation, while optimism remains mediocre in retail.

Survey indicators lower but still above historical average

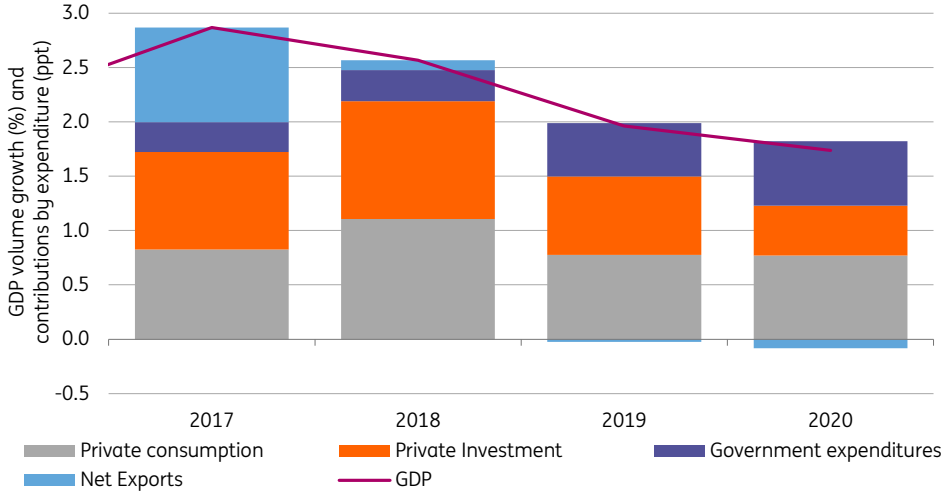


Source: DG ECFIN via Macrobond

Looming risks keep export growth at moderate pace

Export-oriented sectors are being impacted by uncertainty concerning the US trade war with China and Brexit and the consequences of a slowdown in the Eurozone. To date, the direct effect of the trade war on the Netherlands seems negligible, while the anticipated (potentially no deal) Brexit has already caused a fall in Dutch nominal exports to the UK via the depreciation of sterling. The total current account surplus is expected to remain around 10% of GDP. Export growth (3.5%) is projected to be slightly below the historical average in 2019, but somewhat stronger than in 2018 (due to exceptionally weak exports in 1Q18) and weaker than import growth. The yet to be published 2018 figures might show that the Netherlands has become a net importer of natural gas, after decades of surpluses. All in all, we project the net contribution of foreign trade to come in at nearly zero (using the simple method of subtracting the contribution of imports from the export contribution).

Main contributors to domestic demand



Source: Statistics Netherlands via Macrobond, ING estimates for 2018-20F

Moderating consumption growth, while purchasing power steps up the pace

Domestically, normalisation of the number of home sales resulting from limited supply and increasing tightness in the labour market is limiting (consumption) growth, while the fall in stock markets, the (also low interest-rate related) deterioration of the coverage ratio of a number of pension funds and the VAT hike might have affected consumers

towards the end of 2018. Yet, we see real disposable income accelerating significantly in 2019. All in all, we believe consumption growth will moderate to a steady 1.8% in 2019.

Limits of labour market in sight, finally igniting higher wage growth

While the labour market has been a growth engine, it is increasingly becoming a limit to growth. Employment growth peaked in 2Q18, recording 2.5% year-on-year, but we still expect an increase in the number of people finding a job. For a large part, new vacancies have recently been filled by people (re)entering the labour force. As a result, the unemployment rate has fallen more slowly in recent months, to reach a level of 3.5% at the end of 2018. While this might be close to the frictional unemployment level, we forecast unemployment to remain at 3.5% in both 2019 and 2020. Growing businesses will continue to look to make additional hires and will find it increasingly difficult to do so. More than one in four businesses is already reporting a shortage of workers as the main factor limiting production. This increasing tightness in labour demand has finally started to show up in wages, with hourly collective wage (including bonuses) growth increasing from 1.4% in 2017 to 2.1% in 2018.

Policy boosts inflation in early-2019 while wage inflation slowly feeds trough

During the course of 2019, we believe wage pressures could become visible in inflation figures, while having been largely absent in previous years. Nevertheless, we expect CPI inflation to jump mainly as the result of an increase of the reduced VAT rate (from 6% to 9%) and higher energy taxes, from a moderate 1.7% in 2018 to a high 2.6% in 2019. Clothing and communication will put downward pressure one headline consumer price inflation, while food, energy, hospitality and housing will provide the main positive contributions, in our view.

Slowdown in almost all commercial industries

Almost all industries are growing at a slower pace than last year. Commercial services, including IT and job agencies, construction and healthcare are the sectors that we expect to grow at the highest rates again. Continuing above-average growth of commercial services strongly contributes to our moderately positive investment outlook (for 3.4% growth); investment in ICT-items, in particular, have been popular in recent years and are expected to remain so. The healthcare sector will step up its pace of growth as a result of both policy and demographics, while agricultural sector output will accelerate in the absence of the unfavourable weather conditions experienced in 2018. Gas production decreases and shaves 0.1ppt to 0.2ppt off GDP growth, similar to 2018. This results from the political goal to entirely shut off the gas tap in the Northern Province of Groningen in the medium term, in order to reduce further earthquake risks. Growth in housing investment falls strongly due to supply side restrictions reducing construction output growth.

Public debt low and falling despite fiscal expansion

Fiscal policy is largely in check, with continuing fiscal surpluses and rapidly falling government debt. For the long term, only a minor consolidation challenge remains. Government debt was close to 53% of GDP in 3Q18, clearly below the European norm of 60% GDP. It will continue to decrease and drop below 50% of GDP in 2019, on our forecasts. The four-party coalition government is, however, using cyclical tax revenues for procyclical spending, as well as tax cuts, and for offsetting falling gas revenues. In the first three quarters of 2018, however, the government failed to execute its spending intentions, in part because of difficulties in finding suitable personnel. It remains to be seen whether spending plans can be fully executed in 2019, constituting an upward risk to our fiscal balance projection. Fiscal plans have generally been implemented successfully. Most notable, labour taxes were lowered at the start of 2019, while energy taxes and healthcare premiums rose.

Fig 1 The Dutch economy in a nutshell (%YoY)

	2017	2018F	2019F	2020F
GDP	2.9	2.6	2.0	1.7
Private consumption	1.9	2.5	1.8	1.8
Investment	6.1	5.0	3.4	2.1
Government consumption	1.1	1.2	2.0	2.5
Net trade contribution (%-point)	0.9	0.2	0.0	-0.1
Headline CPI	1.4	1.7	2.6	2.0
Unemployment rate (%)	4.9	3.8	3.5	3.5
Budget balance (% of GDP)	1.1	0.5	0.1	1.2
Government debt (% of GDP)	56.9	52.9	49.8	46.8

Source: Statistics Netherlands via Macrobond, all forecasts ING estimates

Spain: Shifting into a lower gear

The economy slowed in 2018 and we think that it is bound to slow further. In part, this is a normal process of the business cycle, but it also has to do with a weaker external environment and political uncertainty

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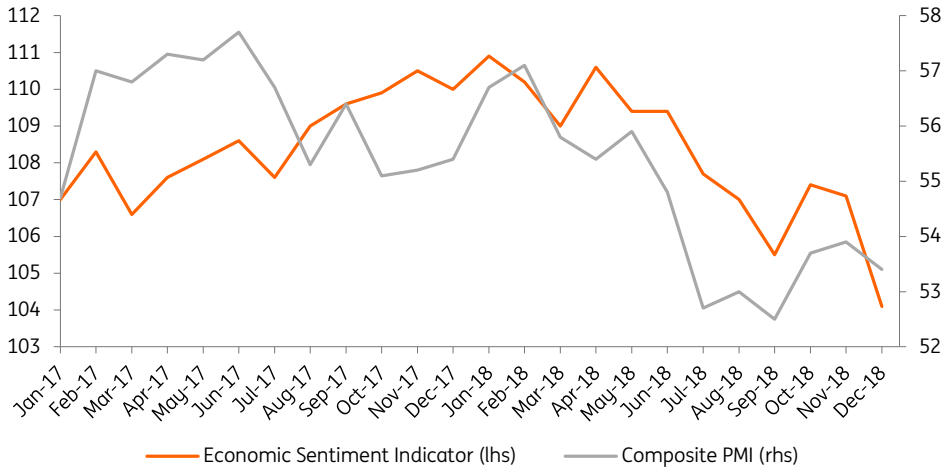
A slowing economy

Survey data started to show a downward trend in early 2018, but stabilised in the third quarter and even recovered a bit after that. Following a few stable months, survey data reverted to a downward trend in December. The Economic Sentiment Indicator even dropped by three points, the sharpest decline in the Eurozone.

Hard data also disappointed, as industrial production contracted by 2% YoY - the worst growth figure since August 2013.

Sentiment indicator heading south



Source: Thomson Reuters

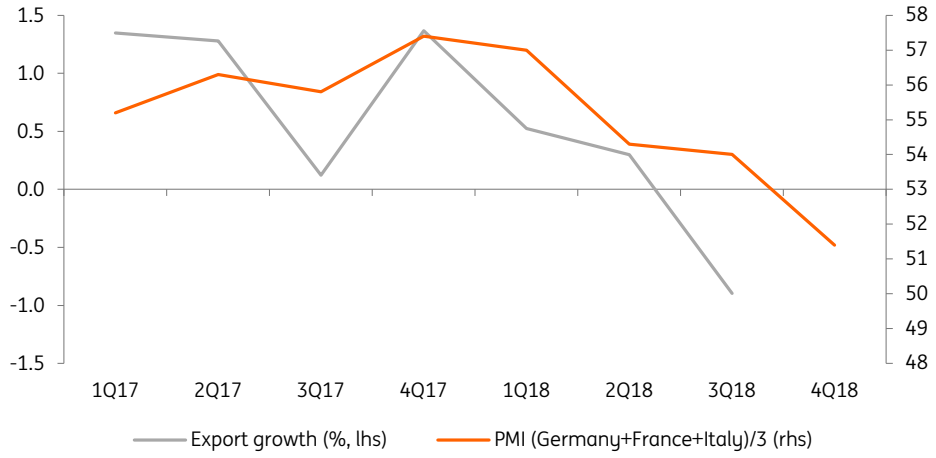
This offers evidence that the economy is slowing further. On an annual basis, GDP growth slowed from 3.1% in the final quarter of 2017 to 2.4 % in the third quarter of 2018. There are several reasons for this.

First, as the economy had been growing at more than 3% on an annual basis since 2015, strongly above the potential growth rate estimated by the European Commission, the economy was bound to slow at some point. According to the EC, the output gap even turned positive in 2018.

Second, export growth slowed, and turned negative in the third quarter of 2018, due to the weaker external environment. Indeed, the economic situation in the three most important export countries for Spain (Germany, France and Italy) clearly deteriorated.

Furthermore, the number of tourists in 2018 was similar to 2017, a record year. While 82 million tourists for two years in succession is a noteworthy performance, it also means tourism wasn't a source of growth in 2018.

Export growth down



Source: Thomson Reuters

Political uncertainty abounds

Political uncertainty can impact growth performance, with companies delaying investment and hiring and consumers waiting before buying that new car - and Spain has had a great deal of political uncertainty recently.

In June 2018, the centre-right People's Party government was replaced by another minority government led by the socialist party with even fewer seats in parliament, the Catalan situation continues to cause tensions, the 2019 budget is still not approved by parliament, and another non-traditional party, Vox, has entered the political equation following the regional elections in Andalucía.

However, the impact of the political uncertainty on the economy is difficult to judge; investment growth and hiring intentions are currently still strong, but may well have been stronger without the uncertainty.

The 2019 budget

The key influence of politics on the economy is, of course, via fiscal policy.

Spanish prime minister Pedro Sanchez recently increased the minimum wage by 22%, from €813 to €900 a month by decree, but to continue with his plans to increase social spending, he needs more room to manoeuvre, for which 2019 budget approval is necessary. Sanchez hasn't succeeded as the budget didn't receive the needed 19 Catalan votes. Recently, the government announced a new draft budget, again supported by Podemos. It would reduce the budget deficit from 2.7% of GDP in 2018 to 1.3% in 2019. The plan increases social spending and increases taxes for the rich. The plan also increases transfers for Catalonia.

The key question is whether this plan will receive the Catalan support. This is difficult to judge given continued tensions, but the increased transfer should make it more attractive to the Catalans.

If this draft does not get approved then the government will keep the 2018 budget, but it has not ruled out snap elections. Snap elections, however, would be a risk for Sanchez due to the recent developments in Andalucía. Following the Andalusian regional elections a right-wing coalition (the People's Party (PP) and Citizens, supported by Vox) came into force, after 36 years of socialist party rule in Andalucía. And the risk for Sanchez is that this coalition could do well at the national level as well. Furthermore, according to the official poll by the Centre of Sociological Studies, the support for PSOE dropped to its lowest level since Sanchez became prime minister in June 2018, even though it remains the largest party.

The year ahead

We see the economy slowing further in 2019 as the elements that caused the slowdown in 2018 are here to stay. The external environment will continue to be a drag, with the Eurozone economy slowing from 1.9% in 2018 to 1.4% in 2019. Political uncertainty is bound to remain high in Spain. In addition, there are local, regional and European elections planned in May. But it is not all bad news. The labour market continues to support consumption. The unemployment rate continues to fall and hiring intentions in both the industry and services remain solid.

All in all, we forecast a 2.0% growth rate for 2019 and 1.6% for 2020.

The Spanish economy in a nutshell (% YoY)

	2017	2018F	2019F	2020F
GDP	3.1	2.6	2.0	1.6
Private consumption	2.5	2.4	2.1	1.7
Investment	5.4	6.0	4.0	2.5
Government consumption	1.9	2.0	1.3	1.0
Net trade contribution	0.1	-0.6	-0.3	-0.1
Headline CPI	2.0	1.7	1.4	1.7
Unemployment rate (%)	17.2	15.4	14.2	13.8
Budget balance as a % of GDP	-3.1	-2.6	-2.0	-2.0
Government debt as a % of GDP	98.1	97.0	95.5	94.4

Source: Thomson Reuters, all forecasts ING estimates

Greece: Defying external headwinds

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Domestic demand is now taking the token of growth as the external background deteriorates. Ongoing employment recovery represents a short-term hedge, helped by the first mildly expansionary budget in a decade. Beware upcoming elections

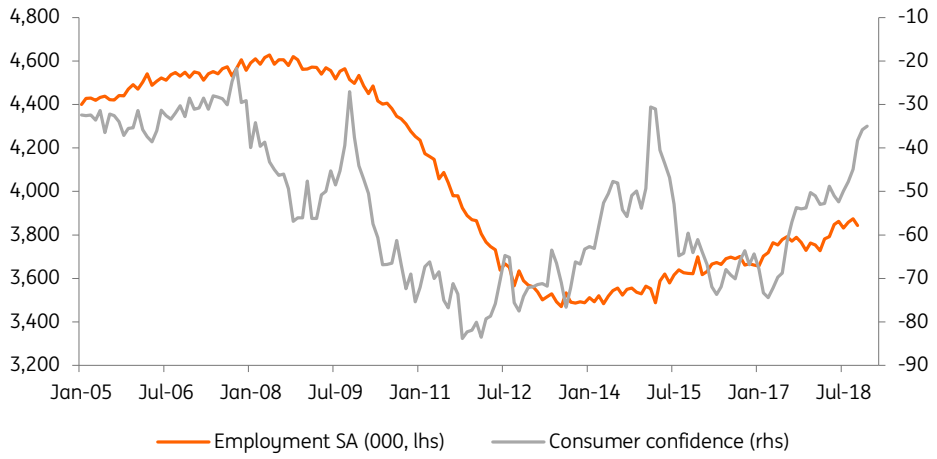
Growth unsynchronised with the rest of the eurozone, for the time being

The Greek economic recovery continues at a decent pace, irrespective of intensifying signals of a slowdown coming from peer eurozone countries. Apparently, the combined effect of a 'clean exit' from the third ESM programme and the positive effect of the recovery on employment have been supporting consumer confidence, which posted a relative high in December. Unsurprisingly, confidence in retail held up decently well as did confidence in service sectors, backed by a strong performance from the tourism sector. Only, confidence in the export-related manufacturing sector has fallen sharply since August, reflecting an ongoing deterioration of the international backdrop.

Domestic demand-driven acceleration in 3Q18

In 3Q18, the seasonally and calendar adjusted Greek GDP expanded by a healthy 1% QoQ (2.2% YoY) accelerating from an upward revised 0.4% QoQ in 2Q18. After adjusting for a re-classification of 3Q17 data causing a distorting base effect, the data shows that economic growth was driven by gross fixed capital formation and by inventory accumulation, with private consumption providing a minor push. The side effect was a sharp gain of imports, with net exports acting as a drag as a consequence, notwithstanding a decent export performance. On the back of available soft data evidence, it seems likely that a domestic demand driven pattern could have applied also to 4Q18, with private consumption possibly playing a bigger role. Indeed, according to ELSTAT data, employment continued to expand at a healthy 1.7% yearly clip over 3Q18, helping to support disposable income. Interestingly, the concurrent decline in the unemployment rate to 18.6% happened when the labour force was expanding and the pool of inactives was shrinking; undoubtedly a positive signal.

Ongoing employment recovery supports confidence pick-up



Source: Thomson Reuters Datastream

Primary surplus target overperformance opened the door to mildly expansionary budget

The acceleration in economic growth has had as a positive side-effect with further progresses on public account data. State budget execution data for the January-November period suggests that Greece should have been able to overshoot its general government budget primary surplus target of 3.5% of GDP for the third year in a row, getting close to a 4% primary surplus in 2018. Such a positive fiscal performance, mainly driven by a significant reduction in primary spending, allowed Athens to approve a budget for 2019 including a set of expansionary measures worth 0.5% of GDP. These will be funded by the recurring element of the fiscal overperformance recorded in the 2016-18 period, while enabling Greece to cancel the implementation of pension cuts that were scheduled for 2019.

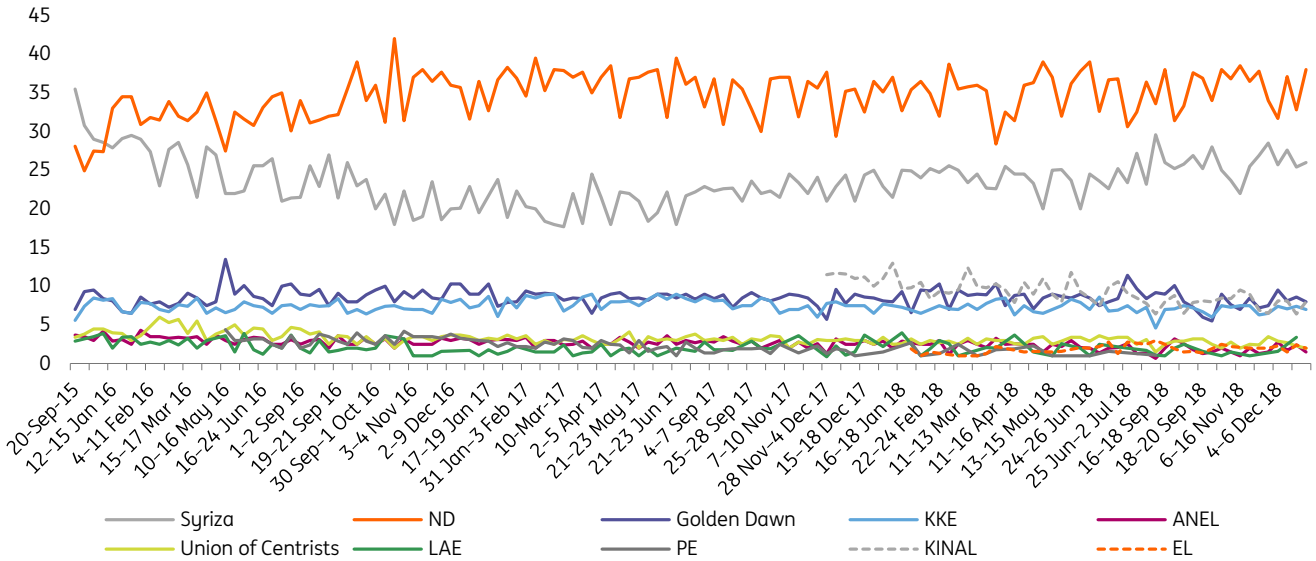
As expected, the clean exit from the third programme has not allowed Greece to immediately regain full control of its state finances. Fiscal and reform constraints remain in place under the enhanced surveillance regime, with the medium-term debt relief measures agreed conditional on them. However, the first fiscal expansion in a decade, marks at least a symbolic break with an unprecedented fiscal adjustment. PM Tsipras, having had his budget smoothly validated by the EU Commission, passed his first post-programme credibility test without incident, obtaining an asset that he could leverage upon in a politically dense year.

A political asset that PM Tsipras will try to leverage upon in both European and national elections

The European Parliament election vote in May and legislative elections, due no later than 20 October, make 2019 a politically dense year. The Prespes Agreement reached between Greece and FYROM to change the name of Greece's neighbour to Republic of North Macedonia, which was strongly backed by PM Tsipras, was opposed by Panos Kammenos, the leader of ANEL, the junior partner in Greece's government alliance. In disagreement over the deal, he decided to quit the government before the ratification vote by the Greek Parliament. PM Tsipras subsequently decided to call for a confidence vote in the government, which was held on Wednesday, 16 January. The vote was passed with 151 votes in favour and 148 against out of 300, supported by all 145 Syriza MPs, by defecting lawmakers from the former coalition partner and by independent MPs. After the vote, Tsipras reiterated that his government would remain in power until the end of the current legislature, at the end of October. We suspect this is far from granted, and that he might be tempted to bring Greeks to the polls before then. In the process, in the wake of ANEL's departure, he is likely to have to try to forge ties with the centre-left,

as opinion polls are still signalling that ND, the main opposition party, is still leading over Syriza by an ample margin. In between, he will soon have to reassure lenders in their second post-programme review that his government is still empowered to fulfil its list of to-does. Not necessarily an easy call.

Opinion polls still pointing to ample gap between leading ND and Syriza



Source: Thomson Reuters Datastream

The Greek economy in a nutshell (%YoY)

	2017	2018F	2019F	2020F
GDP	1.4	2.0	2.0	1.5
Private consumption	0.9	1.0	1.2	1.5
Investment	9.4	-7.0	11.0	7.9
Government consumption	-0.5	-2.6	2.4	1.7
Headline CPI	1.1	0.8	1.1	1.4

Source: Datastream, all forecasts ING estimates

Belgium: Waiting for elections in May

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In 2018, Belgian economic growth remained below the eurozone average, partly due to weak household consumption growth. This year the economy is expected to make only modest progress, while the collapse of the government in December and upcoming elections scheduled for May will limit any new economic policy initiatives

Moderate growth

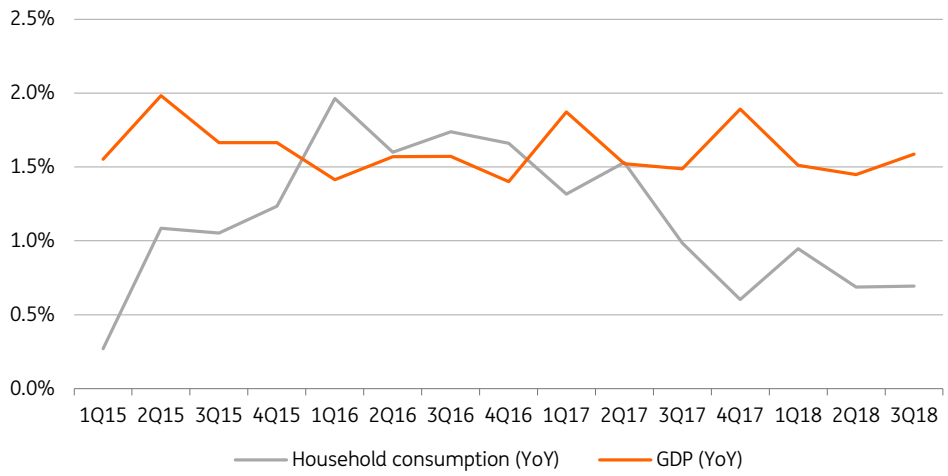
For more information on the upcoming elections, read our detailed Belgium election guide

In 2018 economic growth reached 1.4%, which is well below the euro area as a whole (1.9%). One reason for this poor performance is the sluggish growth in household consumption. In the third quarter, it actually contracted by 0.2% quarter on quarter, probably on the back of higher oil prices sapping purchasing power. Even assuming a rebound in the fourth quarter, household consumption is expected to grow by only 0.8% for 2018 as a whole.

This is all the more surprising as the job market continues to perform well. For the third consecutive year, the Belgian economy has created nearly 60,000 net jobs in 2018. Given the moderate economic growth this is a good performance, and has reduced the unemployment rate to around 6.5%, a level that would normally support household confidence.

We see two explanations for household consumption growth weakness. First, even though in nominal terms household disposable income is progressing well (by around 2.5% YoY, thanks to jobs creation), this increase is almost entirely offset by price increases. In Belgium, inflation reached 2.2% in 2018 (with energy prices one of the culprits). There is therefore little room for a real increase in consumption. Second, households are no longer reducing savings to consume more. Bear in mind that between 2010 and 2017, the savings rate declined from 15% to 11.5% of disposable income. But since then, it has hardly moved.

The support of consumption for GDP is abating (%YoY)



Source: National Bank of Belgium, ING

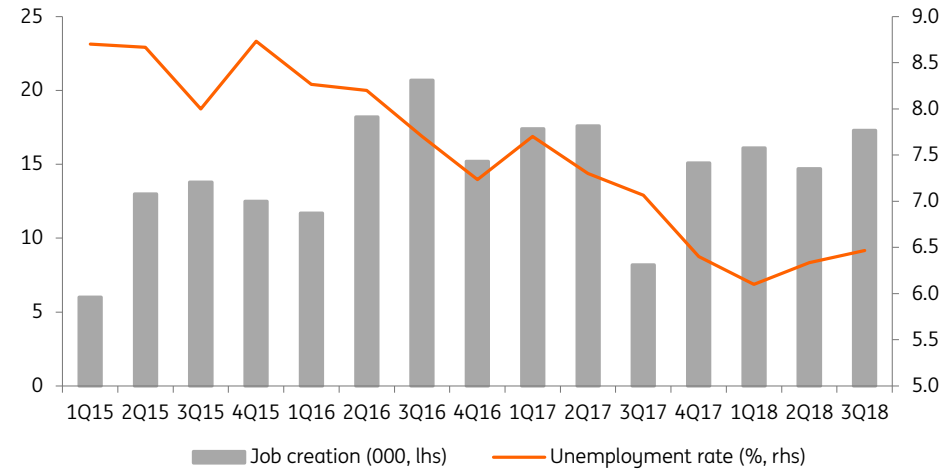
Prudent forecasts

In 2019, we believe the recent indexation of wages and social benefits combined with jobs creation and lower energy costs should help maintain positive growth of household consumption, despite an uncertain general economic background. However, no strong rebound is expected.

Belgian foreign trade, which contributed significantly to economic growth in 2018, risks being affected this year by the weakening of economic growth in the eurozone, by the tensions in international trade (including between the US and the eurozone) and Brexit.

Taking these elements into account, we expect GDP growth to be limited to 1.3% this year and in 2020. It should also be noted that this scenario takes the Belgian political context into account and, in particular, the fact that new economic policy initiatives will be rare in 2019.

Job creation allowed a strong decrease in the unemployment rate



Source: National Bank of Belgium, ING

The long road to elections

Just before Christmas, the Belgian king accepted the resignation of prime minister Charles Michel and the Belgian government. But given that parliament has not been dissolved, the minority government remains in place as a caretaker government and will stay until a new government is in place after the federal elections in five months.

The majority of parties prefer to keep this date and not call early elections so, in the meantime, we shouldn't expect much in terms of economic policy as the government can't take on any initiatives and would have difficulty finding a majority for any propositions anyway.

After the elections, the caretaker government will have to stay in place until a new majority is found, which is likely to take some time. Bear in mind it took 541 days after the 2010 elections to form a new government, and in 2014 it took 4.5 months.

Following the latest polls, various coalitions are possible, and no party would be unavoidable at the federal level. However, the only coalition that could win a majority in both the federal parliament and the Flemish and Walloon parliaments would be the N-VA, the liberals and the socialists. That said, after previous federal and regional elections, the N-VA and the French-speaking socialist party have refused to work in the same government.

Therefore, it is highly likely that the majorities will not be symmetrical between federal and regional levels. Therefore, this will require longer negotiations and diminish the effectiveness of economic policy afterwards. A new state reform could also be the price to pay for having a government at the federal level.

As a consequence, a caretaker federal government will remain in place for most of 2019 without any real economic policy initiatives. But, at the same time, the regional governments are still in place and are often formed faster than the federal government after elections. This situation should not necessarily jeopardise the state of public finances but, admittedly, savings measures decided by the previous government will not now come into force in 2019.

Based solely on the measures that had been voted, the central bank expects a deterioration of the budget deficit, from -0.8% of GDP in 2018 to -1.6% of GDP this year. This deterioration, which does not meet the objectives of the European Commission, would nevertheless allow the debt ratio to fall slightly from 102.3% in 2018 to 101.4% of GDP in 2019.

The Belgian economy will be dependent mainly on the global and European economic context, especially in 2019. But given that no significant growth acceleration is expected anytime soon, Belgian economic activity is likely to suffer.

The Belgian economy in a nutshell (% YoY)

	2017	2018	2019F	2020F
GDP	1.7	1.4	1.3	1.3
Private consumption	1.1	0.8	1.2	1.3
Investment	1.8	1.3	0.6	1.3
Government consumption	0.6	1.0	1.2	1.2
Net trade contribution	0.6	1.0	0.7	0.5
Headline CPI	2.1	2.0	1.8	1.8
Unemployment rate	6.3	6.2	6.3	6.0
Budget balance as % of GDP	-1.0	-0.8	-1.6	-1.2
Government debt as % of GDP	103.0	102.3	101.4	100.2

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

Austria: Crisis ...what crisis?

While the eurozone's economic figures continue to disappoint, the Austrian economy should remain a pillar of strength in 2019

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Private consumption remains an important growth driver

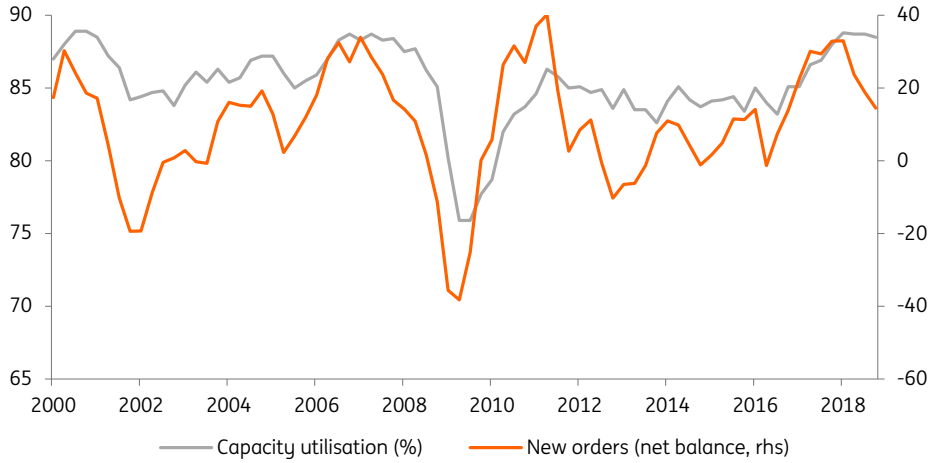
When looking at fundamentals, we see hardly any reason for concern for the Austrian economy. After two boom years, growth rates will simply return to solid levels in the Alpine republic. Up to now, the macro disappointments of the Eurozone have not affected Austria. Admittedly, risks are skewed to the downside, with ongoing trade tensions, Brexit uncertainty and a volatile geopolitical atmosphere. However, we still see Austrian GDP growth of 2.2% in 2019 and 1.8% 2020.

The labour market remains healthy, resulting in strong job growth and rising wages, which will continue to boost household disposable income. In addition, households with children benefit from the government's tax deduction programme 'Family Bonus Plus' as of January 2019, giving an extra boost to purchasing power. As in the previous two years, private consumption therefore remains an important growth driver for the domestic economy. We expect a real private consumption growth rate of 1.7%.

Investment activity is going to abate

While investment growth is expected to abate after expanding strongly in 2018, Austria's capacity utilisation rate, which is still close to its all-time high, does not suggest a sudden stop. However, a drop in the level of new orders in recent months, as well as export expectations for the months ahead, do suggest a slowing of industrial activity in the coming months.

Drop in new orders in recent months suggests a slowing of industrial activity



Source: Thomson Reuters

The main risk for the Austrian economy lies in a further deterioration of the European economy

To date, the external sector has remained largely unmoved by global trade tensions due to a heavy focus on Europe; around 80% of Austria's exports go to Europe. The sputtering of the German economy, Austria's most important trading partner where more than 30% of Austria's exports go, however, might impact its export market more heavily, especially if the expected rebound (see *Germany: Maybe it's time (to let the old ways die)*) of the German economy were to take longer. Also, a significant proportion of Austrian exports to Germany are industrial products, which are often further processed and exported onward to a third country. Therefore, an escalation of the trade dispute could hurt the economy via second round effects. In general, however, the main risk for Austria's external sector lies in a further deterioration of the European economy, rather than in an immediate escalation of trade tensions with the US, even if roughly 7% of its exports go there.

Solid growth path ahead

Despite these downside risks, we see the Austrian economy on a solid growth path for the year ahead. The robust labour market, persistent strong consumption and the slow phasing out of investments justify a stable growth path expectation.

The Austrian economy in a nutshell (% YoY)

	2017	2018F	2019F	2020F
GDP	2.6	2.8	2.2	1.8
Private consumption	1.4	1.8	1.7	1.4
Investment	3.9	3.5	2.9	1.6
Government consumption	1.5	1.2	1.1	0.8
Net trade contribution	0.4	0.7	0.4	0.3
Headline CPI	2.2	2.1	2.0	2.1

Source: Thomson Reuters, all forecasts ING estimates

Portugal: Losing momentum

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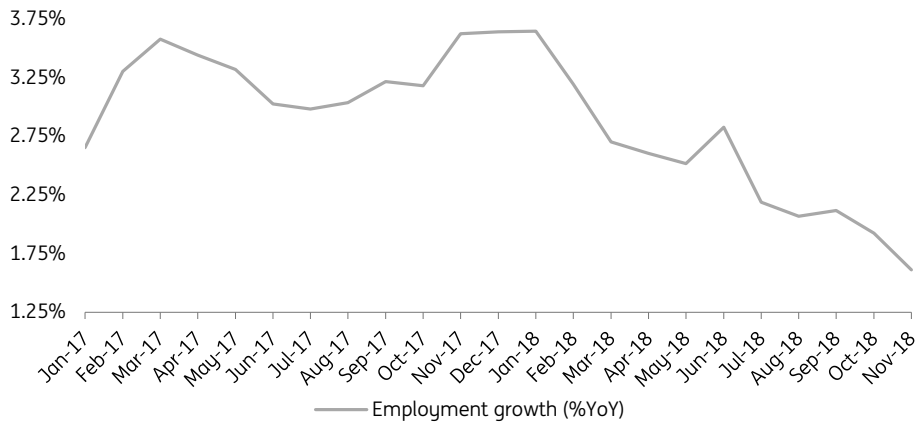
The economy is slowing down and weaker domestic demand and a more fragile external environment will impact economic activity negatively in 2019, which is why we forecast 1.6% growth this year and 1.4% in 2020

The quarterly growth rate in the first three quarters of 2018 averaged 0.4%, compared to 0.6% in 2017. For 2018, we think the economy has grown by 2.1%, compared to 2.8% in 2017. This is still a decent performance, but we think the slowdown will continue in 2018.

Take the loss of momentum in the labour market. The unemployment rate has stopped its downward trend in recent months, coming in at 6.6% since September 2018, and employment growth is also slowing. It was about 3.6% in January 2018 but has since dropped to about 1.60%. The weak labour market helps explain the drop in consumer confidence, which peaked last May and has since dropped quite sharply. Since August 2018, there are again more pessimistic consumers than optimistic ones.

However, all of this is yet to have a substantial impact on consumption growth as it continued to be as dynamic in the first three quarters of 2018 as it was in 2017. But in our view, this will not last, and so consumption growth is bound to come down too.

Labour market seems to have lost its momentum



Source: Thomson Reuters Datastream

Another negative for Portugal is the weaker external environment in its three most important export markets, Spain, France and Germany – and this is already impacting Portuguese exports.

Export growth was negative in the third quarter of 2018, and this will have more of an impact as exports are now more important for the Portuguese economy. Total exports of goods and services as a share of GDP has grown to 47% compared to 32% in 2010. A big part of this increase was due to vibrant tourism.

As weaker economic growth in tourists' home countries impacts the decision to travel, the number of tourists is bound to fall. Growth in the number of tourists coming to Portugal already seems to have stopped, but during the first ten months of 2018, there was a similar number of tourists in the same period in 2017.

All in all, we expect the economy to slow further. We forecast 1.6% growth in 2019 and 1.4% in 2020.

Ireland: Awaiting a Brexit decision

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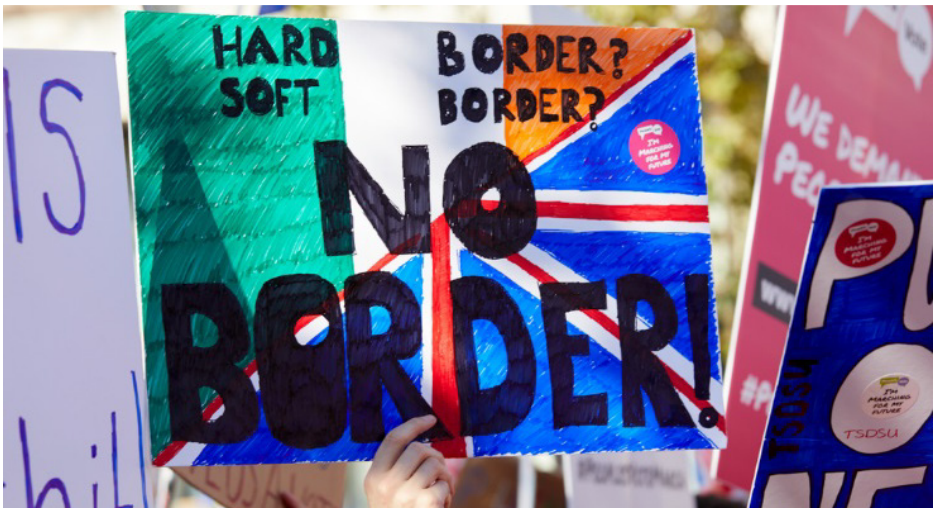
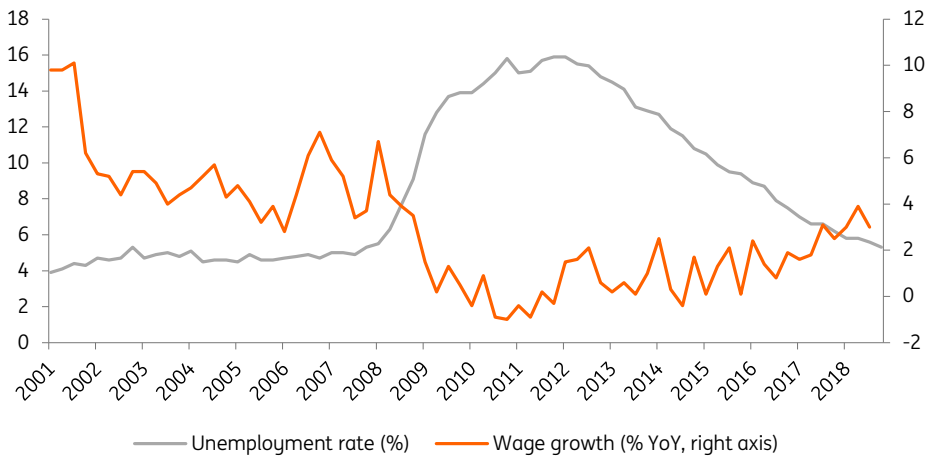
The largest threat to the Irish economy remains a cliff-edge Brexit. With just weeks before the British exit is set to happen, no certainty about any scenario can be given. Whether Ireland can continue robust growth or perhaps even face recession hangs on the final outcome of the withdrawal bill deal.



Stellar growth for 2018

The Irish economy is likely to have ended 2018 with stronger growth than China. Significantly impacted by factors like multinational profits, we expect Irish GDP growth to come in at 6.8% for the year. Regular economic activity has expanded healthily in 2018, with consumption growth of 2.9% YoY in the third quarter. Also investment in building and construction continues to grow at a very rapid pace with 18.4% growth YoY. This indicates that the domestic economy is performing well at the moment, which can also be seen in the labour market. The Irish unemployment rate fell to 5.3% in November, which is well below the Eurozone average of 7.9%. Wage growth of around 3% in 2018, has helped along the consumption recovery. The strong housing investments are related to continued tightness in the housing market although price growth is dropping off somewhat now that significant investments are starting to have some effect.

The Irish labour market is getting very tight as wage growth is rising



Source: Eurostat

But global growth and Brexit uncertainty moving forward

Moving ahead, economic uncertainty is starting to feed into the growth picture. Brexit is a key item here, as less than three months before the UK leaves the EU, it is still not clear what is going to happen. Ireland is like a team in the league that has already played its last match and is anxiously awaiting results from elsewhere to find out whether it's been relegated or not. It is having an effect on the Irish economy as small business lending, in particular, has fallen. This indicates that businesses are delaying investment decisions ahead of some clarity on whether a cliff-edge Brexit scenario can be avoided. Alongside the uncertainty, weakness in sterling continues to have a negative impact on exports to the UK market for Irish businesses.

Businesses have also started to moderate their hiring intentions somewhat as new orders have been coming in at a slower pace than previously. This means that the domestic economy, even though still strong, is likely to be experiencing a slowdown ahead of the Brexit deadline, although it has to be said that hardly all of this can be blamed on Brexit. Any global slowdown has an important impact on the Irish economy, given how open it is. Therefore, trade war concerns and a slowing Eurozone economy are also likely to be important drivers of a slowdown indicated by businesses and uncertainty moving forward. That being said, Brexit will have a significant impact on the Irish economy. Recent estimates by ESRI show a lower GDP in all Brexit scenarios and estimates of a "no deal" Brexit leading to a 4% reduction in Irish GDP over time.

Healthy public finances make Ireland ready for next storm

For the first time since the crisis, Ireland has ended the year with a budget surplus in 2018. This marks a next step in the process of returning to sound public finances following the deep fiscal crisis Ireland was in after rescuing banks and the subsequent bailout required. Government debt rose sharply from 23.9% in the last quarter of 2007 to a peak of 124.6% in the first quarter of 2013. It has since been on the decline and has most recently reached 69.1%, rapidly approaching the threshold of 60% as demanded by the Stability and Growth Pact. The return to the black came faster than expected and has been helped by large corporate tax receipts, partly driven by multinational corporations placing more intellectual property assets in Ireland on the back of the US corporate tax overhaul. The risk of depending on corporate taxes is that the proceeds can be very volatile, making the forecast for the budget in coming years challenging. Regardless, given the state of the Irish economy and government expenditure plans, expectations are that Ireland will continue to run a budget surplus for the years ahead. This could of course be impacted significantly if economic risks were to materialise, but at least it is a sign that Ireland is ready to weather an economic storm again. With Brexit turning into a nail-biter, it could well be that this is just in time.

The Irish economy in a nutshell (%YoY)

	2017	2018F	2019F	2020F
GDP	7.2	6.8	3.8	3.1
Private consumption	1.6	2.9	2.3	1.9
Investment	-31	7.9	7.5	4.9
Government consumption	3.7	3.5	1.6	0.7
Net trade contribution	14.5	1.9	-0.2	0.3
Headline CPI	0.2	0.8	1.0	1.4

Source: Macrobond, all forecasts ING estimates

Finland: Political changes ahead?

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Finland goes to the polls in April after years of strict policies of wage moderation to improve competitiveness. A more left leaning parliament could succeed at a time when Finland has managed to return to sound public finances and closed the output gap. The question is how long modest growth can continue in a weak global economic environment.

Growth has peaked as trade outlook clouds economy

The Finnish economy has slowed significantly since the first quarter of 2018. Just like the rest of the Eurozone, Finland has experienced moderation in its growth rate as the output gap has been closed and the global economy sees mounting risks. After the disappointing 0.3% growth in 2Q18, 3Q18 saw just a small recovery to 0.4% GDP growth. Even though this may be somewhat disappointing after an exceptional pace of growth at the beginning of 2018, it does look like Finland is ended 2018 on a better note than some of the larger Eurozone economies. The question is whether Finland can weather a Eurozone storm given the openness of its economy.

The fourth quarter is likely to have remained quite strong, despite faltering production in the larger Eurozone economies. The Finnish trend output index fell slightly in October, but was up by 2.9% on the year. As September had already seen strong growth, the base effect for 4Q18 is quite favourable. This suggests that concerns about declining output in Germany, France and Italy in 4Q18 have not taken effect in Finland as yet.

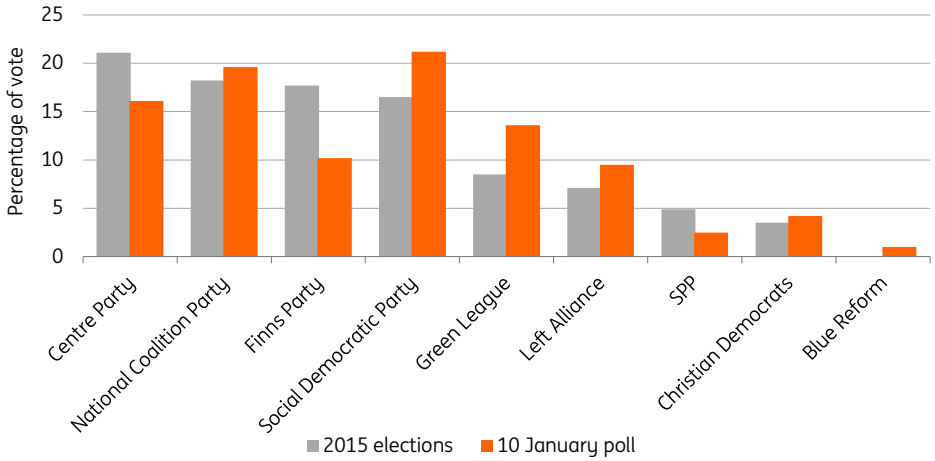
The question is how long this can last. With foreign trade an important engine for growth in Finland, the weakened outlook for the Eurozone is likely to have an impact on the Finnish economy. We expect growth to be weaker than previously expected for the year at 1.6%, with further downside risk due to Brexit and a possible revival of the trade concerns between the EU and the US.

Will Finland lean left at the coming elections?

With elections in April, Finland seems to be heading towards a change in government. Polls over recent months have consistently put the Social Democrats (SPD) in the lead, while coalition partners NCP and Centre Party are in second and third position. The populist former coalition partner Finns Party is in fifth place with about 10% of the vote, which is well below the 18% it received in the 2015 elections although they have been rising in the polls somewhat recently.

Although serious campaigning has not yet begun, the polls would suggest that Finland looks set to return to the more traditional parties and that the left is set to gain. Besides the gains that the SPD have made since the last elections, the Greens are also advancing in the polls and are now the fourth largest party. Economic issues seem to be at least in part responsible for the surge in the polls of the left leaning parties, as recent easing employment legislation proposals have been met with opposition. This is in line with opposition to the competitiveness pact.

Fig 2 Early polls show gains for left wing parties



Source: Yle, Finnish Ministry of Justice

This increases the chances of a more left leaning government than the current centre-right Sipilä cabinet. With Blue Reform currently at just 1% of the vote, a continuation of the current government is highly unlikely. The three governing parties combined represent just 35.7% in the polls for now. A centre-left government could be a possibility, although it would not be straightforward to construct.

Public finances in Finland are sound ahead of the elections. In the second quarter of 2018, government debt dropped below 60% of GDP, marking a return to the target of the Stability and Growth Pact for the first time since 2014. Nonetheless, the budget balance remains negative for the moment as infrastructure spending projects are pushing up government spending. As these projects are one-offs, this will not impact government finances much in the longer run. A small buffer has been created, the question is whether a new government, at a time of slowing growth and unemployment rates higher than neighbouring countries, will be keen to keep things that way.

The Finnish economy in a nutshell (% YoY)

	2017	2018F	2019F	2020F
GDP	2.8	2.4	1.6	1.4
Private consumption	1.3	1.5	2.0	1.9
Investment	4.0	3.4	2.2	1.9
Government consumption	-0.5	0.1	0.3	0.2
Net trade contribution	1.5	0.3	0.0	0.0
Headline CPI	0.9	1.2	1.2	1.5

Source: Macrobond, all forecasts ING estimates

Eurozone: House price growth set to weaken in 2019

House price growth is expected to slow in most eurozone countries. For the eurozone as a whole, we saw residential real estate prices grow by 3.8% and we think this will slow to about 3.1% in 2019

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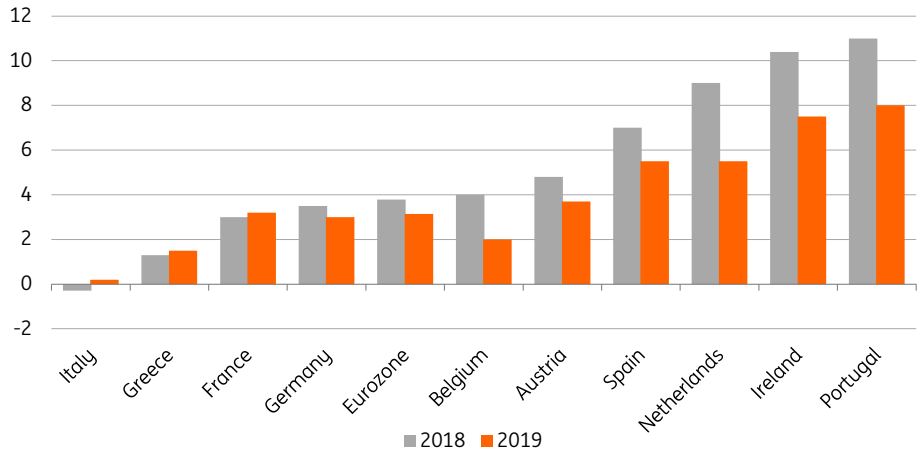
ING forecasts for residential real estate price growth (% YoY)



Source: ING Economic Research

Germany

The real estate sector in Germany continues to boom, and construction activity has been one of the few growth drivers in 2018. Prices for residential properties have increased by around 5% across the country, with still significant differences across urban and rural areas.

Given the cooling of the economy, price dynamics should slow somewhat in 2019 and over the coming years. At the same time, however, low interest rates and the strong labour market, as well as the general trend of urbanisation, should keep any slowdown limited. Despite price acceleration since 2010, loan-to-value ratios have remained relatively stable, keeping the risk of a bursting textbook bubble low.

France

In France, real estate prices dropped by 5.5% between early 2012 and 2015. Since then, they have caught up by 9% overall, and by 12% in Paris, and have actually grown by 3% in 2017 and 2018. We don't expect the rhythm to slow down as big cities are still supporting the overall trend, and price gains in real terms remained fairly limited over recent years. Low interest rates are supporting the market without driving exceptional numbers of transactions as activity even decreased slightly in 2018. The level of anxiety among buyers following the 'yellow vest' crisis is certainly an explanatory factor of the relatively low level of activity in comparison to the level of interest rates, and this will continue to have an impact throughout 2019.

Italy

The slowdown in the pace of economic growth might have some bearing on developments in the Italian residential housing market. After hovering at levels close to historical highs for most of 2018, consumer confidence started falling in November and reached its lowest level in more than a year in December. In 3Q18 house transactions were still expanding at a healthy 6.7% YoY pace (5.6% YoY in 2Q18). The price-to-rent ratio remains close to its lows, and affordability is keeping the purchase option attractive. Purchases continue to be fuelled by loans for house purchases, which were still growing at a 1.3% YoY clip in October 2018. Overall, the mood of real estate agents remains decently upbeat on activity, but times are not yet ripe for a quick turnaround in market valuations. According to the November 2018 BoI/Tecnoborsa/OMI survey, an increasing share of agents expected prices to stabilise over the next 12 months (81.7% in 3Q18 from 76.6% in 2Q18), while the share of those expecting prices to rise edged down (to 2.0% from 3.9%). The loan to value ratio stood at 74.9% and the ratio of house purchases financed via mortgages at 78.9%, confirming the relevance of credit availability for house purchase developments.

On price developments, the recent evidence is mixed. The BoI survey shows that the average final discount practiced by sellers on the original offer price increased again to 10.8% in 3Q18 (from 9.9% in 2Q18); on a similar note, average selling time was also up, to 8.2 months (from 7.5 months in 2Q18). We expect the ongoing moderate recovery of disposable income, in conjunction with still cheap mortgages, to further support house purchases, but at a softer pace than we previously anticipated. Given the remaining slack in the market, we expect average house prices to edge up only marginally in 2019, and to post a modest acceleration in 2020.

Spain

House price growth accelerated again in the third quarter of 2018, after a gentle slowdown in the beginning of the year. The year-on-year growth rate in 3Q18 was equal to 7.3%, the highest since the eurozone crisis. The recovery in the labour market supports this development. Admittedly, the economy slowed in 2018, but the unemployment rate continues to decline, and employment growth remains strong. As we think the Spanish economy will continue to slow, this should impact house price. We, therefore, think house price growth will slow to 5.5% in 2019.

Netherlands

In 2018 the average house price increased by 9.0%, surpassing the figure in 2017 of 7.6%. Home sales numbered 218,000, well below the number in 2017 (242,000). Since the trough of 2013, the average house price has increased by 34%. On a national level, the house price has fully recovered from the crisis and is currently 5.0% above the 2008 price peak. For 2019 we expect the price increase to flatten to 5.5% and home sales to further decrease to 200,000. Tightening of the housing market is expected to continue until 2020 so upward price pressure remains. The increased interest of private investors in the Dutch housing market is further pushing prices up. Two factors work to lower

upward price pressure. First, a deteriorating affordability of homes (driven by continuing price increases) will reduce housing demand. As mortgage rates have passed their lowest points, this will not compensate for the price increase. Second, the catch-up effect of households that postponed moving plans during the crisis and have pushed up housing prices up since 2013, is now marginal. Note, estimates for 2018 are based on monthly data up to and including 3Q18. The Dutch Land Registry has not published 4Q18 data yet.

Belgium

The macro economic situation in 2018 continued to support the real estate market. During the first three quarters of 2018, there were more transactions than in the same period in 2017 (from about 30,400 per quarter in 2017 to 31,500 per quarter). There was also an acceleration in price growth, from 2.7% in 2017 to 3.9% (based on the three first quarters of each year). The affordability of residential real estate has remained stable since 2016. We measure the growth potential as low in the years to come, mainly due to a slowdown in the world economy which has a strong impact on a small open economy such as Belgium. Moreover, the National Bank of Belgium estimates that residential real estate prices are about 5.5% overvalued, which also limits upward potential. We continue to forecast 2% growth in nominal prices. In real terms this implies that the price of residential real estate remains constant.

Portugal

At the start of 2018, house price growth peaked under the impulse of a strong economy and foreign demand. In 1Q18, price growth of existing residential real estate grew by 13.0%. But since then it has declined to 12.6% in 2Q18 and 9.2% in 3Q18. We expect this downward trend to continue, given the signs of lost momentum in the domestic labour market and weaker external demand (see piece on Portugal).

Austria

In Austria, gross fixed capital formation is currently one of the growth pillars for the economy with strength coming from construction investment. While the sharp increase in building permits in 2017 (+6.8%) suggests ongoing growth in housing construction for 2019, the decline in building permits in the first half of 2018 points to somewhat weaker construction activity in 2020. Nevertheless, residential property prices remain elevated, growing by 6.1% YoY in the first half of 2018. 78% of Austrians expect property prices in their neighbourhood to increase further within the next year, according to a representative ING survey. Some 84% of Salzburg's citizens and 83% of those living in Vienna believe that housing will be even more expensive, from an already very high base. With growth momentum expected to cool down somewhat, we expect the same for momentum in housing prices. However, for the time being and within the current economic environment, the prospering real estate market continues to be well supported, keeping prices at elevated levels.

Ireland

The Irish housing market is slowly starting to feel the impact of a prolonged period of investment in supply. Slowly but surely the excess demand in the housing market is starting to come down as the new supply of houses increases. This is also noticeable in price growth, which has come down to below double-digit growth rates. In April 2018, residential property prices rose by 13.3% but had come down to 8.4% growth by October. As supply continues to come through, the Irish housing market is expected to cool further.

Greece

The acceleration in economic recovery that accompanied the exit of Greece from its third ESM programme brought about new employment gains. During 3Q18,

employment expanded by 1.7% YoY, fuelling consumer confidence further. Certainly, the delicate position of Greek banks on NPLs is still weighing on house-purchase related mortgage lending but accelerated NPL disposal initiatives from the main systemic banks should, in principle, help improve lending conditions.

Lending for house purchases was still contracting in November 2018, at 2.9% YoY. Another potential positive might lie with the reduction in the ANFIA taxation on real estate assets included in the 2019 budget. Taking into account that external factors tilt risks to GDP growth to the downside, we still see the ongoing modest recovery in Greek housing prices to continue in 2019 at a slightly accelerated pace.

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