ING

Eurozone Quarterly: Is this recovery for real?

There are gradually more signs that the eurozone economy is bottoming out after a deceleration that started in January 2018. However, survey data seems to reflect some hope for improvement, while hard data still remains poor. Although the economy is likely to improve, 2020 is unlikely to see much stronger growth than in 2019

THINK Economic and Financial Analysis

16 December 2019

Follow us
@ING_Economics

Contents

Eurozone Quarterly: Is this recovery for real?	1
Eurozone: Is this recovery for real?	3
Germany: Entering the lost decade	6
France: Moment of truth for Macron's reform ambitions	9
Italy: Hardly growing, with lingering political risk	14
The Netherlands: A milder slowdown thanks to fiscal	18
Spain: Weaker growth ahead	22
Greece: Still in search of a stable growth pattern	25
Belgium: A year later, the stand-off continues	28
Austria: Modest, but stable	31
Portugal: Economy to slow but the fiscal picture should improve	33
Ireland: Brexit and future trading anxiety	35
Finland: Better than others, but far from immune to a slowdown	37

Peter Vanden Houte
Chief Economist Belgium, Eurozone
+32 2 547 8009
peter.vandenhoute@ing.com

Eurozone: Is this recovery for real?

There are gradually more signs that the eurozone economy is bottoming out after a deceleration that started in January 2018. However, survey data seems to reflect some hope for improvement, while hard data still remains poor. Although the economy is likely to improve, 2020 is unlikely to see much stronger growth than in 2019

Trade to the rescue?

For the economy to recover, we need to see the animal spirits reviving. Although sentiment indicators have indeed improved over the last few months, we don't see much progress in hard data yet.

To be sure, the German Ifo-indicator rose for the third month in a row in November, while the European Commission's economic sentiment indicator registered a stronger than expected increase last month. The €-coin indicator, a real-time estimate of the underlying growth pace, rose slightly from 0.13 in October to 0.15 in November, although this still suggests rather weak growth. There is hope that trade could offer some relief in 2020.

As a matter of fact, the eurozone is a far more open economy than both China and the US, explaining why the fall in global trade on the back of the trade war provoked significant collateral damage in Europe. Other positive news was the fact that President Donald Trump didn't announce higher tariffs on European cars. This would have been an additional blow to the already battered German car industry. Finally, Boris Johnson's landslide victory in the UK elections offers at least the advantage that there will now be more clarity on Brexit, although the negotiations for a new trade deal between the UK and the EU might still prove to be laborious.

Real data still weak

While the news flow has certainly been improving, a robust upturn is not to be expected. The more cyclical business climate indicator even decreased to -0.23 from -0.20 in October. This chimes with a further fall in the assessment of order books in the industrial sector. Employment expectations declined in all sectors in November, which might have a dampening effect on consumption. Several big German firms announced significant lay-offs over the last month.

Admittedly, the German unemployment figures remain reassuring, but such headline news might make consumers more cautious. Eurozone rail sales actually dropped by

0.6% month-on-month in October, after a 0.2% contraction in September. One of the other first 4Q real indicators also looked rather bleak. Industrial production in the eurozone fell 0.5% month-on-month in October, after a 0.1% decline in September, so the fourth quarter has already started on a rather weak footing.

Weak real data

Source: Refinitiv Datastream

Structurally low growth

That is the reason why we remain quite cautious in our growth outlook. We are looking at quarterly growth rates for the eurozone close to 0.1% in both the last quarter of 2019 and the first quarter of 2020. Even with a gradual acceleration from 2Q20 onwards, we think the eurozone will struggle to achieve a growth rate above 1.0% next year. We pencil in 0.7% GDP growth in 2020 and 1.1% in 2021.

> *"We pencil in 0.7% GDP growth in 2020 and 1.1% in 2021"*

For the time being there is little reason to expect a change in the subdued growth story, which seems to be of a more structural nature. With labour force growth further slowing over the coming years and productivity gains rather subdued, the growth potential in the eurozone is definitely not going to be more than 1.5% and is probably closer to 1.0%. While there are always doubts about the computation of the size of the output gap, there is probably only a small negative output gap left, meaning that GDP growth will be at best only slightly above-potential growth in the coming years.

The ambitious green deal announced by the new European Commission might raise hopes of higher investment in the future, but this is likely to be spread out over a very long period, which means that it would only have a marginal effect in the near future.

Inflation remains subdued

Inflation increased from 0.7 to 1% in November with core inflation rising from 1.1 to 1.3%. Except for energy prices, all the underlying series increased, with the largest jump happening in services prices. Could this be the start of an upward trend?

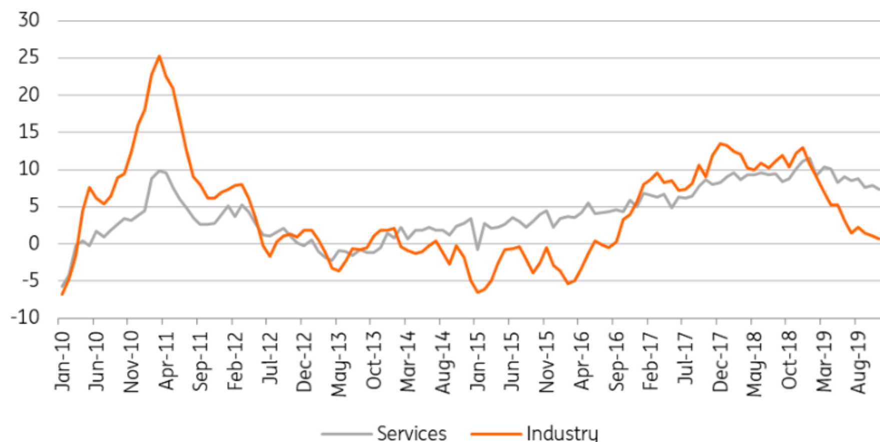
Looking at wage dynamics, which have been strengthening over the last year, it is tempting to say that the Phillips curve is finally reasserting itself with the tighter labour markets finally leading to stronger inflation. However, this process is unlikely to gain much traction over the coming year.

As a matter of fact, in the consumer surveys, labour market perspectives have been deteriorating over the last few months, a phenomenon that is likely to temper wage inflation. At the same time, selling price expectations have been falling in both industry and services - a sign that eurozone businesses still have little pricing power. To be sure, we think that inflation is likely to creep higher, but it will happen at a snail's pace. Both

for 2020 and 2021 it still looks unlikely that average inflation is going to come out above 1.5% - and that is more or less also the ECB's assessment.

In the introductory statement to the December press conference, the ECB president Christine Lagarde said "measures of underlying inflation have remained generally muted, although there are some indications of a mild increase in line with previous expectations. While labour cost pressures have strengthened amid tighter labour markets, the weaker growth momentum is delaying their pass-through to inflation". The ECB staff now expects inflation to come in at 1.1% in 2020, 1.4% in 2021 and 1.6% in 2022.

Little pricing power



Source: Refinitiv Datastream

Steady as she goes

With inflation still short of the ECB's objective, you could argue that the ECB will have to do more. But that doesn't seem to be on the cards, as the strategic review which starts from January will examine, among other things the definition of inflation. E.g. the question whether housing should be included more prominently in inflation measures or not.

No hard conclusions are to be expected before December 2020, which probably means that in the meantime monetary policy will remain on hold. And we actually think that little change is to be expected over the next two years.

As for bond yields, we have the feeling that we are now past the low point. With monetary policy reaching its limits and more calls on fiscal policy, bond yields are likely to settle in a gentle upward trend. However, the short run is still likely to see some volatility, as the short term dataflow might temper the expectations on the strength of the upturn.

The Eurozone economy in a nutshell (% YoY)

	2018	2019F	2020F	2021F
GDP	1.9	1.2	0.7	1.1
Private consumption	1.1	1.0	1.1	1.0
Investment	3.7	3.1	-1.0	0.2
Government consumption	1.0	1.2	1.3	1.0
Net trade contribution	-0.1	-1.1	0.0	0.0
Headline CPI	1.8	1.1	1.4	1.3
Budget balance (% GDP)	-0.5	-0.7	-0.8	-0.9
Refi rate (eop)	0.0	0.0	0.0	0.0
10yr Bund (eop)	0.24	-0.40	-0.20	-0.05

Source: Thomson Reuters, all forecasts ING estimates

Carsten Brzeski
Chief Economist ING Germany
+49 69 27 222 64455
carsten.brzeski@ing.de

Germany: Entering the lost decade

The short-term prospects for the German economy aren't really that bad. With a bit of global tailwind and political will, a rebound in 2020 could well be on the cards. It's more the longer-term prospects which are concerning. While growth in the last decade looked effortless, the next ten years could easily end up as a lost decade

The last decade was a golden one for the German economy, except for the last 18 months obviously.

Strong economic growth, record-high employment and record low unemployment combined with a record series of annual fiscal surpluses had all marked and contributed to the best economic performance since reunification. Unfortunately, this golden decade hasn't really ended in a golden way. The manufacturing slowdown since the summer of 2018 has become a slump, the labour market shows first tentative bruises and, even worse, disruption in one of Germany's key industries, automotives, do not bode well for the imminent future.

In fact, there is a risk that the German economy is almost seamlessly moving from a golden decade into a lost decade.

Two sides of one economy

Headlines on the German economy have been dominated by speculation about whether or not the eurozone's largest economy would fall into recession.

The economy avoided a technical recession at the very last minute, with 3Q GDP growth coming in at 0.1% quarter-on-quarter. However, as exciting as this speculation about a technical recession might be, including relief, once the recession had been avoided, the hard reality is that the German economy has been in de facto stagnation since the summer of 2018. Under the surface of this stagnation, there is a two-faced economy: a weak manufacturing sector, which has moved from slowdown to slump on the back of trade conflicts, global uncertainty and disruption in the automotive sector, and a strong domestic sector, where private and public consumption are important growth drivers.

Let's look at this two-sided economy in more detail. As regards manufacturing, supply-side constraints have given way to demand-side ones. While in the summer of 2018, capacity utilisation was at record highs and the lack of adequate equipment and skilled workers argued in favour of more investments, demand as a limiting factor to

production at the end of 2019 was back at levels last seen in 2012. Trade conflicts and the global slowdown are one reason for the manufacturing slump. On top of that, the structural challenges for the automotive sector, stemming from the transition to electric engines and car-sharing, are increasingly taking a toll. As regards consumption, one important reason why the economy has avoided recession is a long list of election gifts, often criticized as not increasing the long-term growth potential of the German economy. Over the last two years, the government has agreed to increase child allowances, pensions and study allowances as well as some tax relief and more money for health care, elderly care and schools. For 2019, all of this has amounted to a fiscal stimulus of some 0.5% of GDP. So much for the urban legend that the German government is completely averse to the idea of short-term fiscal stimulus.

Up to now, strong domestic demand has offset the manufacturing slowdown. Looking into 2020, it remains uncertain whether this balancing act can continue. In fact, in our view either the cyclical factors weighing on German industry will dissipate somewhat, with the entire economy rebounding, or the domestic part of the economy will also slow down. In our base-case scenario, global trade will rebound somewhat and low-interest rate and the weak euro should further support the export sector. Just in time to avoid a significant weakening of consumption and consequently pushing GDP growth close to 1%. Also, don't forget that more working days should increase annual GDP growth by some 0.4 percentage points.

Structurally (much) less sound

Despite a minor cyclical rebound in 2020, the risk is high that the German economy will suffer fom a series of structural challenges in the coming years.

Just think of demographic changes, the lack of structural reforms over the last decade, the loss of international competitiveness, mainly on the back of too little investments in conventional and digital infrastructure, a possible continuation of de-globalisation and further disruption in the automotive sector. Contrary to the recessions in 2008/9 or 2012/13, the German economy is currently structurally less sound.

"The risk that the German economy will experience a decade with much weaker growth than in the 2010s is high"

The risk that the German economy will experience a decade with much weaker growth than in the 2010s is high. Against this background, the debate on additional fiscal stimulus will continue. Not in the sense of a short-term recession-fighting package but rather in the sense of a long-term investment package, tackling the structural weaknesses of the economy. In this regards, it is remarkable that even the government business association, BDI, and the country's trade union federation, DGB, are teaming up to a plea for an investment package of 450bn euro over the next ten years.

Given the increasing public and electorate support for more investments, we continue to expect more fiscal stimulus than currently planned by the government in 2020 and in the years after. Ironically, the increasingly chaotic political situation in Berlin could help.

Turbulent politics could support more fiscal stimulus

The new party leaders of the SPD Saskia Esken and Norbert-Walter Borjans, had been campaigning for an early end of the current coalition demanding more investments.

Since their official appointment at the SPD party convention, however, these calls have started to sound much less ambitious. Demands and threats have moved into calls to talk with the coalition partner. At least for now, the risk of an early end to the current government has been avoided. For the CDU of Angela Merkel, fiscal surpluses remain carved in stone and continue to be an important cornerstone of their political identity.

Consequently, the fiscal room for manoeuvre has a natural lower bound, ie a balanced budget.

However, given that the government currently still runs a budget surplus of around 1% of GDP and off-budget investments have happened in the past, significant fiscal stimulus could still see the light under the current government. Don't forget that the government agreed on the climate change package amounting to some 50bn euro over the next four years and has increased its efforts to invest in digitalisation somewhat. In our view, the tensions within the government could lead to additional fiscal stimulus, advancing and upping elements of the climate package.

A lost decade on the cards?

The short-term prospects for the German economy aren't that bad. With a bit of global tailwind and political will to engage in more investments, a rebound in 2020 is on the cards. It is rather the longer-term prospects of the economy which are worrisome. While growth in the last decade looked effortless, leading to a golden decade, without reforms and investments, the next ten years could easily end as a lost decade.

The German economy in a nutshell (%YoY)

	2018	2019F	2020F	2021F
GDP	1.6	0.6	0.6	1.2
Private consumption	1.2	1.5	0.4	0.5
Investment	3.5	2.7	1.9	3.1
Government consumption	1.4	2.1	2.4	2.6
Net trade contribution	-0.4	-0.4	0.0	0.0
Headline CPI	1.9	1.4	1.2	1.6
Unemployment rate (%))	3.5	3.2	3.3	3.4
Budget balance as % of GDP	1.6	1.8	1.1	0.9
Government debt as % of GDP	60.8	58.0	57.0	55.0

Source: Thomson Reuters, all forecasts ING estimates

France: Moment of truth for Macron's reform ambitions

Julien Manceaux
Senior Economist, France, Belgium, Switzerland
+32 2 547 3350
julien.manceaux@ing.com

One year after France was paralysed by the "yellow vest" crisis, social unrest is once again taking centre stage, this time as a result of protests on pension reform. It is still too soon to say if the government will succeed in buying its way out of the crisis again, but the early 2020 outlook must certainly be considered with caution

1% Our estimate for French GDP growth in 2020

Lower than expected

Another rocky end of year for Macron

On 5 December, France saw the largest industrial action since railway strikes paralysed the country in the second quarter of 2018 (when the government decided to reform the national rail operator SNCF). Most unions joined the movement in December but mainly in the public sector (public transport and hospitals, justice, schools). Unrest is expected to continue until the end-of-year holiday period.

Pension reform is another politically symbolic move that President Macron pledged to enact during his campaign and is opposed by the same people involved in the yellow vest protests, reflecting a divided France. Public support for the reform (or at least what they know about it) is fading overall (29% supporting it in early November, against 33% in October in an Elabe poll) and is very weak among extreme right and left voters (where 79% and 72% oppose it, respectively). However, support remains strong among La Republique En Marche voters (80%) and The Republicans (43%).

The biggest question, therefore, is whether this will revive the grass roots yellow vest movement which paralysed the country in the final quarter of 2018 and first quarter of this year (without being backed or organised by unions and which went well beyond the public sector). There is a high risk that the 800,000 people marching across France on 5 December will do so again: a recent poll by Elabe showed that two thirds of the French public are expecting more social unrest. However, it seems that the yellow vest movement has faded after a long period of national debate gave way to new public

spending (estimated at €17 billion or 0.7% of GDP). Can the Government buy is way out of the current tensions. It is possible.

The impossible reform

The aim of the pension reform is to merge – as of 2025 - the 42 different French pension regimes into one, based on the number of years each worker has contributed throughout his or her career, rather than a given retirement age. The official age (62 years old, but 67 years old with full pension rights) should not be challenged, the aim being to increase the actual age of departure (currently closer to 61 if the OECD is to be believed, having been below 60 during the period 1993-2015). Another survey by Elabe in early December showed that 67% of French people are in favour of a single common pension system, 57% think that workers will need to work longer and 55% agree that the current system is not financially sustainable (the last official report showed a likely deficit of 0.5% of GDP in 2025). Put simply, there is a consensus on the need for action, little clarity about what is actually in the reform and little willingness to pay for it. That is why we think that the government could again buy its way out.

This is what Prime Minister Édouard Philippe tried to do on 11 December when detailing the government's proposal. By leaving out all those born before 1975, ensuring a minimum pension allowance (at 85% of the minimum wage), ensuring higher allowances for women and parents of large families and offering extra guarantees to school teachers, Philippe has tried to minimise opposition to the reform. The financial trajectory of the new system is still to be determined and lies largely in the hands of social partners in forthcoming negotiations. The amount of the bill is yet to be known but is certainly lower than the cost of leaving things unchanged, unless the final reform does exactly that.

Nevertheless, uncertainty around social stability will remain high in the months to come at a time when the French economy is set to face external risks. We are therefore very cautious about GDP growth at the beginning of next year.

Current growth rates rest on consumers

The second half of 2019 should still see higher GDP growth rates than in the rest of the eurozone. So far this year, France has been the main contributor to eurozone GDP for the first time since the financial crisis. GDP growth was 0.3% quarter-on-quarter, slightly weaker than in 2Q19 (0.35%), confirming that a 1.3% GDP growth rate is reachable for 2019 as a whole. In the second half of 2019, it was mainly a domestic demand story. In particular, GDP numbers for the third quarter continued to show the strength of the private consumption engine.

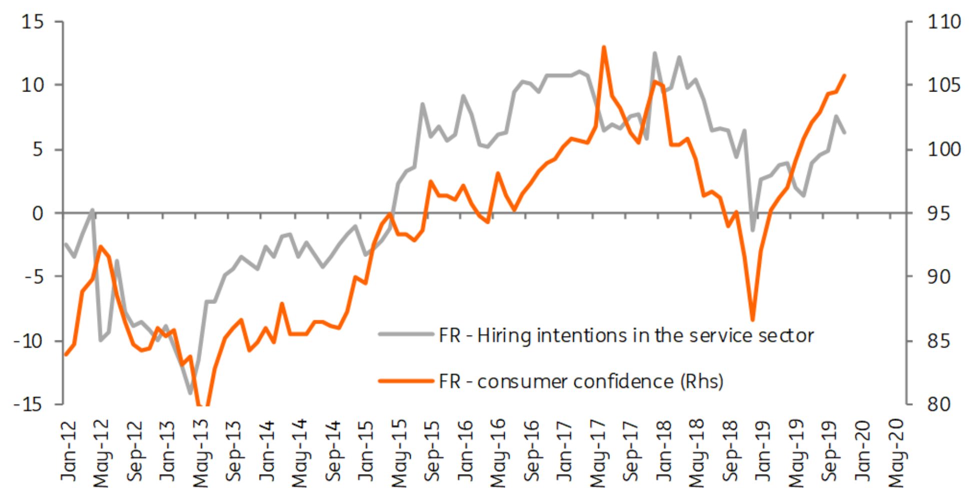
Private consumption growth reached 0.4% QoQ in 3Q19 and the fourth quarter has also started on the right note: consumer expenditures on goods were up by 0.1% month-on-month in October. The spike was especially strong in food and transport equipment. Given that household purchasing power has increased by 0.6% in 3Q19 (thanks to higher wage growth and higher social benefits), we expect this trend to remain positive.

Consumer confidence surveys, in particular, indicate that purchasing intentions remained very high in November: at -4, the index has not been higher since March 2018. Consumer confidence as a whole even increased in November on the back of stronger confidence in the economic environment and employment prospects. Fear of unemployment has reached its lowest level since 2008. In this regard, we did not see any strong correction in the large drops seen in the unemployed population registered in August and September: unemployment was broadly stable in October and hiring intentions remain elevated in the service sector. This should lead to further declines in the household saving ratio, which peaked at 15% in 1Q19 and was down to 14.2% in

3Q19, supporting consumer spending. Over a year, private consumption rose by 1.4% in 3Q19, which should lead to 1.2% growth in 2019 after the 0.9% achieved in 2018.

In addition, household investment in new construction experienced a rebound in 2Q19 (+1.7% QoQ) and 3Q19 (+0.7% QoQ). It should be noted that the fall in mortgage interest rates after 2014, even if it took time to have an impact, has allowed investments to rebound from 2016 onwards: growth since then has averaged 3.6% per year. We expect the catch-up to continue in the first half of 2020.

French consumer confidence is high but for how long?



Source: Refinitiv Datastream

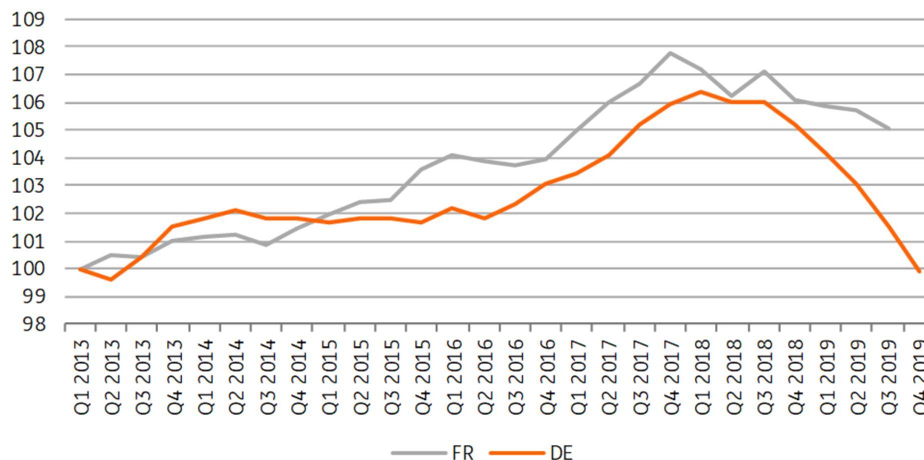
Business investment remains strong despite global downturn

Despite the drop in sentiment seen throughout Europe and especially in neighbouring Italy and Germany, French indicators remained robust throughout the second half. PMI indicators have rarely fallen below 50.0 and industrial production has slowed less steeply than in other countries (it was slightly lower than a year ago at the beginning of 4Q19). Capacity utilisation has remained high in comparison with Germany. However, confidence indicators suggest the stagnation in activity is likely to continue with a toxic mix of rising inventories and declining order books.

Thanks mainly to the service sector and very supportive credit growth, business investment continued to perform well in the third quarter. With growth of 1.2% QoQ, this was above expectations. Even if we see a slowdown in the last quarter of the year, business investment growth should still reach 4.1% in 2019 after 3.9% in 2018.

It should also be noted that public investment growth continues to contribute positively to GDP. After several years of negative contributions (2013-2016), public investment boosted growth by 0.3% in 2018, a figure that is expected to double this year. Thus, after growth of 2.4% year-on-year in 2018, this should grow by nearly 4% in 2019. Even if it's still 4% below the 2008 level, this is certainly a welcome comeback.

Capacity utilisation in industry (1Q13 = 100)



Source: Refinitiv Datastream

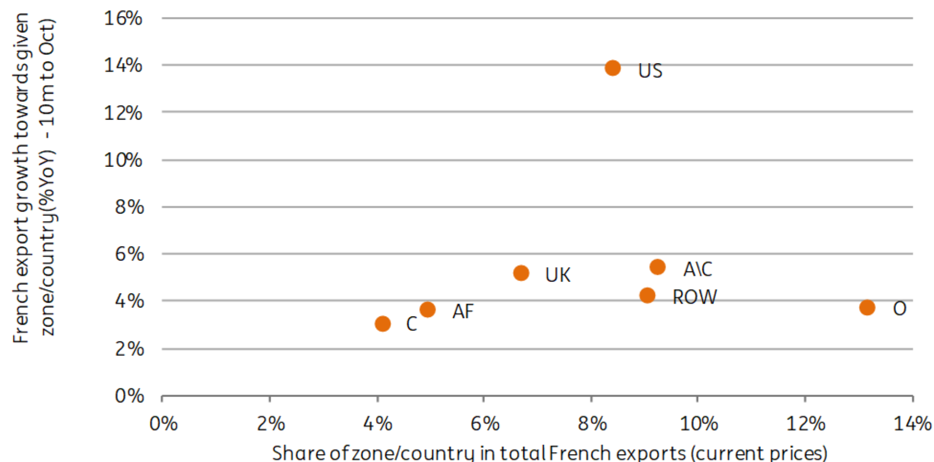
External demand is becoming less supportive

Despite the trade war and the slowdown in global export growth, French exports have benefited from the euro weakness. In the first 10 months of 2019, export growth to the eurozone slowed to 2.2% (compared to 5.1% over the same period last year), all other regions posted higher growth rates (Figure 3).

The trade balance with the US has strongly improved since the beginning of 2018 and is balanced for the first time in 15 years. President Trump has recently pledged new taxes on €2.4 billion on exports of wines and luxury bags, but these items are not the main factors behind the improvement. Aircraft exports (€12.2 billion) represent more than 25% of French exports to the US and increased by 49% in 2019. So while tariffs on champagne and luxury bags are likely to hurt French exports, the main shock will come from the new 10% tariff increase that the US will impose on Airbus exports. This new phase of the trade war should affect French exports in 2020.

While net exports had a particularly high contribution to growth in 2018 (0.6% was the highest since 2012), we do not think it can be repeated in 2019 and 2020. For this year, we expect a slightly negative effect on growth from foreign trade. On one side, the slowdown in world trade and eurozone growth had an impact on French external demand. On the other, the recovery in domestic demand should continue to support imports. This outlook should deteriorate further in 2020 where we expect a 0.4% negative contribution from net exports on the back of the new tariffs and a stronger euro.

French exports to the US have outperformed



O (EU28 excl EZ and UK); A\C (Asia excl China); C (China); AF (Africa); US (USA); UK (United Kingdom); ROW (Rest of the World)

Source: Refinitiv Datastream

Accident prone

The hard data is still encouraging for the last quarter of the year, but the beginning of 2020 looks far from accident prone. Business investment growth will abate with the manufacturing slowdown and a renewed period of uncertainty triggered by social unrest. The labour market- which is still the main factor supporting current growth- could also slow down earlier than expected because of this instability, sending consumer confidence back down. At this stage, we do not expect the impact to be as large as during the yellow vest crisis of 2018, but the unrest around the pension reform will negatively affect 1Q20 growth: larger episodes of strikes and a prolonged manufacturing slowdown could lead to temporary hiring freezes and hit consumer sentiment, which is why we expect a slow start to the year, limiting GDP growth to 1% in 2020 after 1.3% this year.

The French economy in a nutshell (%YoY)

	2018	2019F	2020F	2021F
GDP (%)	1.7	1.3	1.0	1.2
Private consumption (%)	0.9	1.2	1.3	1.4
Investment (%)	2.8	3.6	3.3	2.7
Government consumption (%)	0.8	1.3	1.5	1.1
Net trade contribution (%)	0.7	-0.2	-0.4	-0.2
Headline CPI (%)	1.9	1.1	1.0	1.4
Unemployment rate	9	8.6	8.5	8.9
Budget balance as % of GDP	-2.5	-3.3	-2.4	-2.1
Government debt as % of GDP	98.4	99	98.8	98.6

Source: Thomas Reuters. All forecasts ING estimates. Unemployment rates according to ILO definition

Italy: Hardly growing, with lingering political risk

Paolo Pizzoli
Senior Economist, EMU, Italy, Greece
+39 02 55226 2468
paolo.pizzoli@ing.com

The Italian economy continues its very low growth spell, flirting with stagnation. The finalisation of the 2020 budget will likely absorb much of the government energy until year-end. The domestic political risk looks set to increase before a crucial regional election in late January

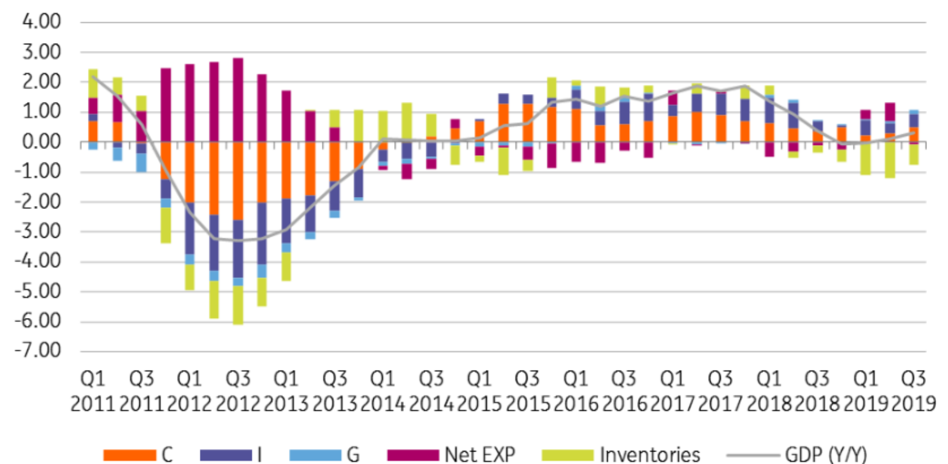
Still flirting with stagnation, with a bigger role for domestic demand

After a technical recession in 2018, the Italian economy has been experiencing quasi-stagnation ever since, with average quarterly growth at a meagre 0.08%. The headline GDP growth for 3Q19 was no different, but the demand breakdown changed somewhat. The net exports drive, which characterised 1H19, faded, with revived imports outweighing flattening exports.

The baton of growth was passed on to private consumption, which benefited from the combined effect of resilient employment and low inflation on disposable income. Interestingly, after being a drag for almost a year, inventories also provided a quarterly push to growth over 3Q19. The flat contribution of gross fixed capital formation looks like the logical result of persisting uncertainty on the US-China trade dispute, of softening manufacturing and of domestic political uncertainty, culminated in a change of government in August.

Softening investments were also consistent with business surveys, increasingly pointing to insufficient demand rather than insufficient factories/capacity as a limiting factor to their production activity.

Domestic demand is now the biggest contributor to growth



Source: Refinitiv Datastream, ING

...and little scope for imminent acceleration

Data on 4Q19 looks consistent with a continuation of the soft economic patch. Confidence indicators have been sending mixed signals of late, with business confidence stabilising both in the manufacturing and in the service sectors; and consumer confidence falling. The PMIs dynamics was broadly consistent, pointing to a recession in manufacturing and to a mild expansion in services. Hard data available for October showed a decent labour market report conflicting with soft industrial production data, suggesting confirmation of the recent pattern.

The 0.2% MoM increase in employment and the concurrent fall of the unemployment rate to 9.7% seemed to support the idea that the past labour market resilience is still in place. This should in principle help confirm private consumption as a growth driver, at least in the short run. This is certainly possible, but some indicators are flagging the risk that fresh job creation might meet obstacles in the months ahead. In the November survey, consumers expressed increasing concerns on developments in unemployment over the next 12 months. Still, with inflation still tame, notwithstanding November's uptick, we expect private consumption to remain supportive to growth in the short term.

Investment developments remain more uncertain. Bank lending to non-financial corporations adjusted for sales and securitisations are now firmly in contraction territory. Selective lending and limited appetite to borrow by very liquid high-quality businesses might be at the heart of the contraction in credit. Indeed, the October Bank of Italy's Bank lending Survey signalled a marginal tightening of credit standards to NFCs in 3Q19 together with non-accelerating demand for loans. Lingering uncertainties in the international backdrop, with the US-China trade dispute, apparently not in for an imminent solution adds an element of caution on investment perspectives. Scarce visibility on domestic political developments complete the picture. Gross fixed capital formation will unlikely be a growth driver over 4Q19.

Looking into 2020, domestic demand should still characterise the first part of the year, where consumption inertia might get limited support from a mildly expansionary budget. An eventual rebalancing towards net exports seems crucially dependent on developments in the trade dispute.

New government, old problems

The Conte 2.0 government, backed by the 5SM, the PD, Italia Viva and Leu, devoted most of its debut time to craft a budget compatible with European constraints. The finance minister Gualtieri managed to strike a balance, submitting a mildly expansionary draft

which solicited only moderate criticism from the Commission, without explicit requests for corrections.

The “pro-Europe” twist of the new government dramatically reduced the risk of a repetition of the “EDP threat” saga of the previous government, with a positive bearing on BTP-Bund spreads, which averaged around 130 bp over Sep-Oct. Still, this was not sufficient to strengthen the cohesion of the government alliance. The regional vote held in the small Umbria region late in October, marking a sharp fall for the 5SM, was a catalyst for political instability within the government alliance.

Since then Di Maio’s 5SM political leadership has been rather openly questioned by part of his party. In an attempt to re-affirm his leadership, Di Maio has again sought visibility with euro-critic calls. The attack of the League’s leader Salvini on PM Conte’s management of the ESM reform file offered Di Maio a convenient but slippery handle to ride the wave and flex his muscles before his government allies.

To be sure, being part of the government, he could not use the aggressive revamped anti-euro rhetoric used by Salvini but managed nonetheless to re-awaken doubts about whether the pro-euro conversion of the 5SM is genuine or not, prompting fresh tensions on spreads. We don't believe that he will push the situation so far as to induce a government crisis before the approval of the budget near the end of the year. Instead, we feel that the decision of the Eurogroup to delay the final approval of the ESM reform to 1Q20 might be enough to cool down a bit of the political temperature, at least in the very short term.

Political risk to rise as Emilia regional vote approaches

More crucially, the Italian domestic political risk might increase again as we get close to the regional election on 26 January 2020 in Emilia Romagna - a historical stronghold of the Italian left. There, the incumbent PD candidate will run against a contender from the League (supported by the whole right-centre). As the risk of a defeat for the PD is far from negligible (competing candidates are running neck and neck in the polls, with a small lead for the PD’s one as we write), this will represent a serious test for the survival of the current government alliance.

Unlike in the case of small Umbria, a defeat of the PD candidate in big Emilia would likely be heavily leveraged upon by the opposition in the national political debate. The destiny of the current government will thus likely depend on whether the PD, the 5SM and their smaller allies will be able to distil a synthesis on a revamped common program before that vote, to weather a possible storm in the polls.

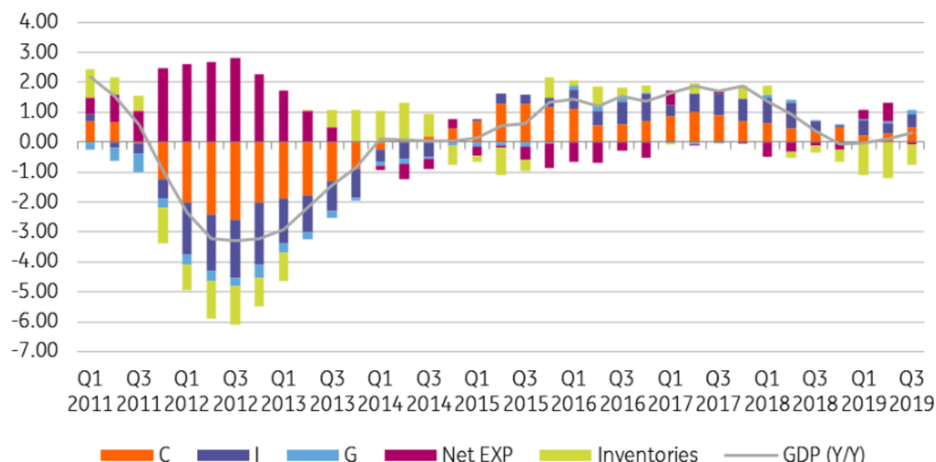
Confirmatory referendum of constitutional law might add to political noise

Interestingly, the Emilia polling date will come soon after the deadline for the request of a confirmatory referendum on the Constitutional Law which trimmed the cumulative number of MPs from 945 to 600. Should the request be indeed submitted (the relevant collection of signatures is currently underway), the implementation of the law would be suspended until the referendum will be held (possibly in June).

This would open a February-June window of opportunity for a government crisis and for early elections to be held under the old rules, which would in principle "save" parliamentary seats for all participants. While not per se a decisive factor, this could turn out to be an incremental incentive to pull the plug should the tensions within the current coalition become unmanageable.

National opinion polls continue to point to right centre ample lead

National opinion polls continue to point to right centre ample lead



Source: Various sources

A short-term compromise possible, but suspect it will not last long

Despite the above mentioned risks, we think that, for the time being, no party in the government has a strong incentive to pull the plug and provoke a government crisis and, therefore a snap election.

With opinion polls consistently pointing to a neat victory for a right-centre coalition led by the League, this could be political suicide. Among intense spikes of political noise, we still see room for a short-term compromise between members of the current majority, but remain skeptical this could last the entire legislature.

The Italian economy in a nutshell (%YoY)

	2018	2019F	2020F	2021F
GDP (%)	0.7	0.2	0.4	0.6
Private consumption (%)	0.8	0.4	0.6	0.6
Investment (%)	3.0	0.2	0.5	1.5
Government consumption (%)	0.4	0.1	0.1	0.3
Net trade contribution (%)	-0.3	0.2	-0.7	-0.2
Headline CPI (%)	1.2	0.6	0.7	1.2
Unemployment rate (%)	10.6	9.9	10.1	10.0
Budget balance (% of GDP)	-2.1	-2.2	-2.3	-2.0
Government debt (% of GDP)	134.8	136.0	136.7	136.2

Source: Refinitiv Datastream, all forecasts ING estimates

The Netherlands: A milder slowdown thanks to fiscal

Marcel Klok
Senior Economist, Netherlands
Amsterdam + 31 20 576 0465
marcel.klok@ing.com

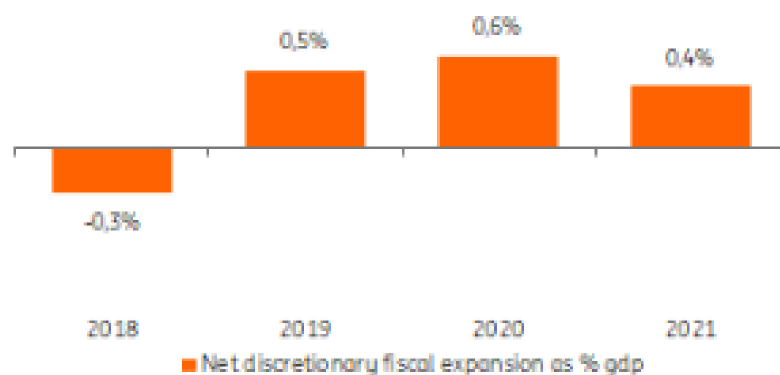
The Dutch economy is set to grow by 1.5% in 2020, something of a minor slowdown. With tax relief for households and additional spending, the government is providing a counterbalance for a reduction in investment. Environmental policies, which could have posed a downward risk, have largely been adjusted

1.5% GDP growth rate – 2020 forecast

Mild slowdown as economy is supported by fiscal policy

The Dutch economy is starting to show signs of a slowdown and the outlook for investment is considerably bleaker for 2020. However, thanks to fiscal policy, no major slowdown is expected. We forecast GDP growth to decline from 1.7% in 2019 to 1.5% 2020, and 1.3% in 2021. For 2021, supply-side constraints are holding back the pace, as the labour market remains tight.

Considerable discretionary fiscal expansion

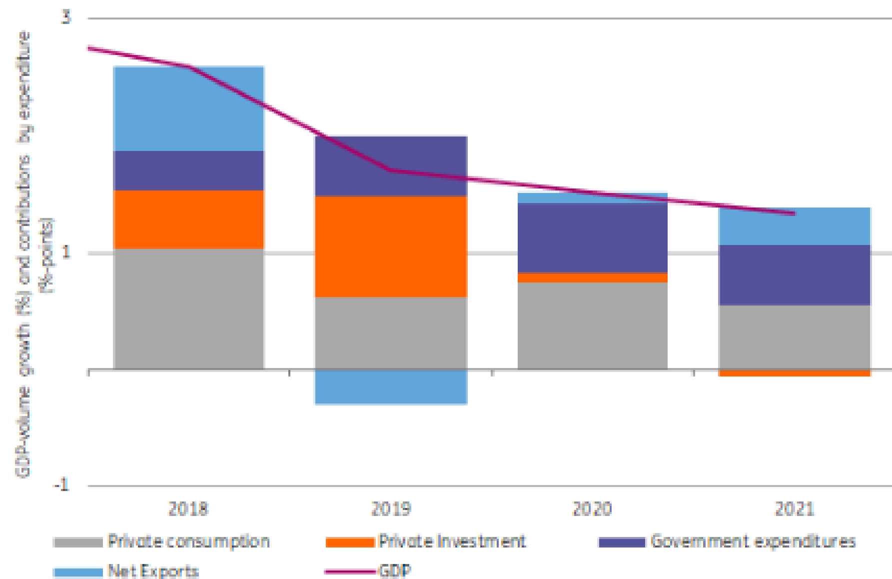


Source: CPB, ING estimates

2019 in line, but investment outlook poor

2019 has developed broadly in line with our expectations. Growth in 3Q19 was quite solid, with 0.4% QoQ. Yet, investment was already posting minor falls quarter-on-quarter. Combine that with worsening business survey indicators and a still subdued global trade outlook, we suggest you shouldn't expect much from businesses as far as expenditure is concerned next year. We forecast investment growth of only 1.5% for 2020.

Boost from private investment fading



Source: Statistics Netherlands via Macrobond, ING estimates

Small growth contribution from trade while external surplus remains large

Export growth is forecast again to be below historical averages, but slightly higher than in 2019. This hides a quarterly profile with a poor end to 2019 and a bad start to 2020. That's on the assumption that things get worse before they get better on the China-US trade dispute. Due to robust domestic demand growth, imports are likely to outpace exports. The current account surplus is expected to stay above 9% of GDP and, all in all, we only project a small positive net contribution of foreign trade and export growth of 2.7%.

Household consumption accelerates due to tax relief

Household consumption is forecast to accelerate to 1.7% on the back of a fiscally boosted increase in purchasing power, while ongoing real house price increases are boosting wealth. Lower employment growth and moderate confidence levels are preventing a spending spree.

Environmental policy concerns on construction and investment

Environmental legislation has been one of the significant concerns for the Dutch economy lately. Dutch policy tools for restricting nitrogen emissions did not comply with European Union standards. This became apparent in May when the Council of State published a ruling on the subject. This instantly meant a significant effect on the processing of permits for (construction) projects that involve nitrogen emissions. Construction production has slowed down as a result, but it's maintained positive growth thanks to full order books.

In November, the government announced the first mitigating measures (such as lowering the speed limit on highways) and more is promised to follow soon. This means

that the delay in permit processing is reduced significantly, mitigating the effects for the construction sector and the economy as a whole.

A change in environmental approach

The second environmental issue which popped up in 2019 concerned PFAS (Polyfluoroalkyl substances which are commonly used in manufacturing but are potentially highly toxic): the government started to police very strict PFAS rules. The construction sector suffered some negative effect on production in 4Q19 since projects were either stopped immediately or delayed. Since the government significantly adjusted the rules in November, this is no longer considered a factor holding back construction on a national scale. Nevertheless, the environmental issues made us revise our construction (and accordingly investment) outlook for 2020 from 3.5% growth to only 0.5%.

Minor increase in unemployment due to extra labour supply

Unemployment is forecast to come in at 3.5% in 2020 and 2021, a little higher than in 2019. Employment growth continues, but at a much slower pace than in 2019 and below the speed of labour supply. While the Netherlands is on the eve of a decline in the working age population, labour supply continues to grow due to rising participation rates.

Consumer sentiment stabilises but business more pessimistic

Economic sentiment is close to historical averages, but underlying dynamics are different. While consumer sentiment appears to have stabilised, business sentiment seems to be on a downward trajectory. Where manufacturing was the first to lose confidence, other sectors have now also slowly started to lower their optimism. Consumers probably have lost part of their easiness due to looming cuts in pensions and increases in pension premiums. The fact that the government has recently granted a number of pension funds one-year extra time to get their coverage ratio seriously scrutinised may prevent consumer confidence from taking a nosedive in 2020. Nevertheless, it seems savings rates will be higher in 2020 than in 2019.

Lower inflation but upward pressure from wages

CPI-inflation is expected to fall from a high 2.6% year-on-year in November 2019 to 1.8% for the year in 2020, as the base effect of an increase in the reduced VAT rate and energy taxes disappears. Wage growth has been on the rise, posting 2.7% year-on-year in November for collective wage agreements, keeping the Dutch HICP inflation rate above the eurozone average for 2020.

Public finances still fully in line with EU norms

Government debt stood at 50.8% of GDP in 2Q19, safely below the European norm of 60%, and will continue to drop as a result from an increasing GDP and the sale of shares of ABN AMRO Bank. Fiscal policy is clearly expansionary, with discretionary policy adding 0.6%-points to GDP growth (according to changes in the structural budget deficit) in 2020. This is mainly the result of lower labour income tax for workers. Tax relief for business is negligible in 2020 and less than announced in the coalition agreement of 2017.

The Dutch economy in a nutshell (% YoY)

	2018	2019F	2020F	2021F
GDP	2.6	1.7	1.5	1.3
Private consumption	2.3	1.4	1.7	1.2
Investment	3.2	5.2	1.5	0.6
Government consumption	1.6	1.4	2.0	1.7
Net trade contribution (%-point)	0.7	-0.3	0.1	0.3
Headline CPI	1.7	2.7	1.8	1.6
Unemployment rate (%)	3.8	3.4	3.5	3.5
Budget balance (% of GDP)*	1.5	1.1	0.0	-0.6
Government debt (% of GDP)	52.4	50.2	48.0	46.5

Source: Statistics Netherlands via Macrobond, all forecasts ING estimates, *Budget balance projection deviate from official forecasts by the Netherlands Bureau of Economic Policy Analysis (CPB) due to differing views on the output gap.

Spain: Weaker growth ahead

Steven Trypsteen
Economist, Spain and Portugal
+32 2 547 3379
steven.trypsteen@ing.com

Economic activity remained elevated in 2019, but there are reasons to think it will slow in 2020. A weaker domestic labour market and a weaker global environment will slow activity. Political uncertainty is likely to ease somewhat but overall will remain high

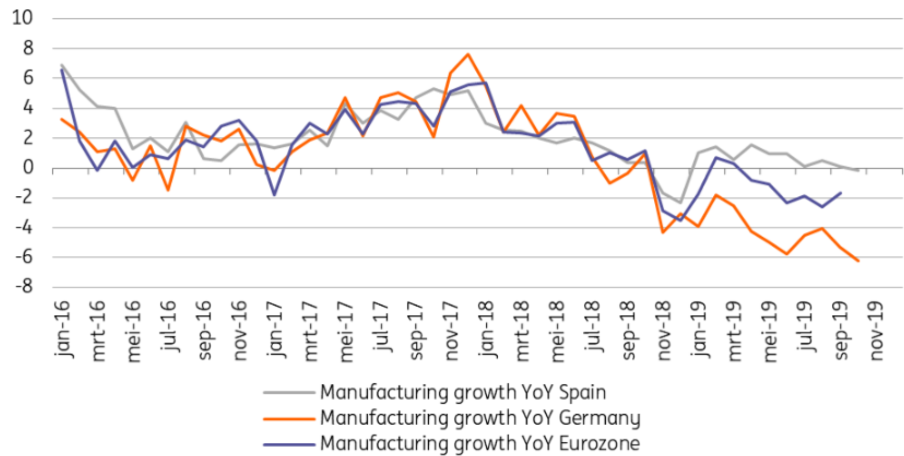
A good growth performance in 2019

Compared to the eurozone as a whole, Spanish economic growth held up nicely in 2019. During the first three-quarters of 2019 average quarterly growth equalled 0.46%, while this was 0.51% over the same period in 2018. Investment growth slowed over the course of the year, while export growth accelerated. Household and government consumption growth remained relatively stable.

The performance of the manufacturing sector was quite good, given the global environment. Compared to a year ago, manufacturing production was flat in Spain, but decreased by about 2% in the eurozone and by a whopping 6% in Germany.

Even though growth performance in 2019 was relatively good, labour market developments were not. The unemployment rate stopped declining at the beginning of 2019 and it now hovers around 14%, which is a lot higher than the 8% before the financial crisis. Similarly, employment growth slowed, while the employment rate stagnated at around 69%, which is still significantly lower than 76% observed before the crisis. All this might point to a severe case of hysteresis in the Spanish labour market.

Compared to the eurozone, Spain's manufacturing sector performed well in 2019



Source: Refinitiv Datastream

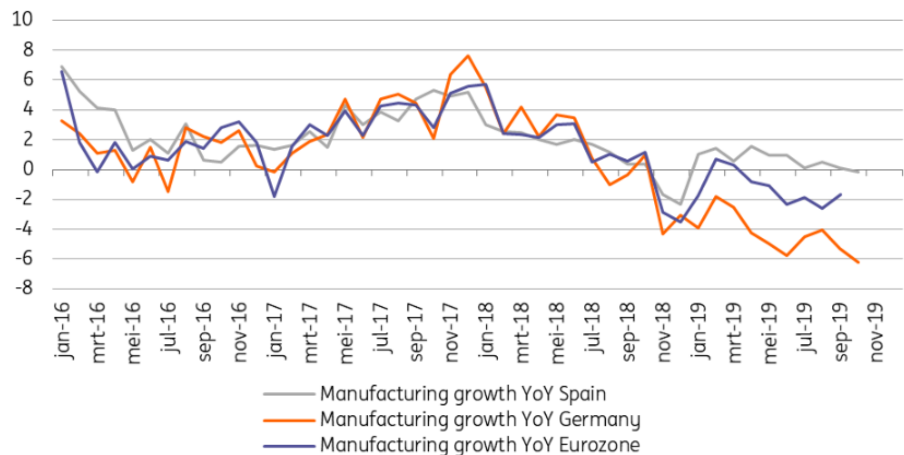
Weaker growth in 2020

The weaker labour market did not yet have a strong impact on consumption, but consumer confidence started to drop during the summer months and is now at its lowest level since January 2015. In our view this lower consumer confidence will negatively impact consumption in the months ahead. Intentions to make major purchases by consumers over the next 12 months dropped already quite a bit.

It is not likely that the unemployment rate starts to drop significantly again as hiring intentions in the industry dropped in recent months. Furthermore, the manufacturing sector will probably weaken further in 2020. Industrial production expectation fell recently which will impact labour demand negatively.

Slower consumption growth is not the only reason why we expect slower growth in 2020. The weaker external environment is another one. Growth in the eurozone and the United States is forecasted to slow further in 2020, which will negatively impact Spanish export growth. It is also likely that the tensions and uncertainty surrounding international trade are not going to disappear soon. The threat of tariffs by the US on cars, which is the largest Spanish export sector, hasn't materialized yet, but has not completely disappeared.

The unemployment and employment rate plateaued



Source: Refinitiv Datastream

Will political uncertainty recede in 2020?

Political uncertainty has been elevated during the last couple of years and 2019 was no different. Hence, the snap elections in April and November.

The November elections weakened the PSOE and Podemos, compared to the elections in April, but one day after the November elections they made the decision to form a minority government. To have enough support in parliament, they are now trying to convince the ERC (Catalan Republican Left) to abstain during the vote in parliament so the coalition government could be formed. However, ERC only wants to help the minority government if it gets some concessions in return, something which is still difficult.

This option is certainly not a done deal. Moreover, there are other possibilities. Recently, Inés Arrimadas, the new leader of Ciudadanos, said she is willing to work on a PSOE-Partido Popular-Ciudadanos government, although this looks to be a long shot.

However, we do think that pressure to form a government is high and this increases the likelihood that there will be a government soon as the main political parties are unlikely to fare any better in new elections. Once there is a government, political uncertainty should in principle decline however the type of government will also have an impact. A minority government is by definition not that stable and the political fragmentation and polarisation has only increased during the latest elections and this political reality won't be changing anytime soon.

Political uncertainty could hamper investment and hiring decisions, but it also impacts fiscal policy. As the Spanish government debt level is above 60% of GDP, the government should lower it at a fast pace. The no policy change draft budget submitted by the current caretaker government to the European Commission, however, did not go far enough.

According to the European Commission, Spain should use the decline of interest rate expenditures to reduce the debt ratio and urged Spain to submit a new budget consistent with the rules as soon a new government is formed. This warning, of course, makes the government formation more difficult.

All in all, we think that growth will slow in 2020. We expect a GDP growth rate of 1.4% in 2020 and 1,5% in 2020, compared to 2% in 2019.

The Spanish economy in a nutshell (%YoY)

	2018	2019F	2020F	2021F
GDP (%)	2.4	2.0	1.4	1.5
Private consumption (%)	2.4	2.0	1.7	1.9
Investment (%)	6.0	2.0	1.5	1.6
Government consumption (%)	2.0	2.0	1.5	1.5
Net trade contribution (%)	-0.2	0.0	-0.1	-0.1
Headline CPI (%)	1.7	0.7	0.7	1.5
Unemployment rate (%)	15.3	14.2	14.0	13.8
Budget balance (% of GDP)	-2.5	-2.2	-2.0	-2.0
Government debt (% of GDP)	97.6	97.2	97.2	96.4

Source: Thomson Reuters, all forecasts ING estimates

Paolo Pizzoli
Senior Economist, EMU, Italy, Greece
+39 02 55226 2468
paolo.pizzoli@ing.com

Greece: Still in search of a stable growth pattern

The Greek economy has paid a high economic and social price for the consequences of the debt crisis, but it is recovering albeit at an unspectacular speed. For the time being, we think it will outperform the eurozone

Volatile growth data over 1H19 suggested that the Greek economy is still in search of a sounder growth pattern. The unequivocally strong recovery in business and consumer confidence has yet to match hard domestic demand data, be that private consumption or gross fixed capital formation.

The passage of the baton of growth from exports to domestic demand proved to be short-lived, and the latest national account numbers confirm this.

Exports defy external headwinds

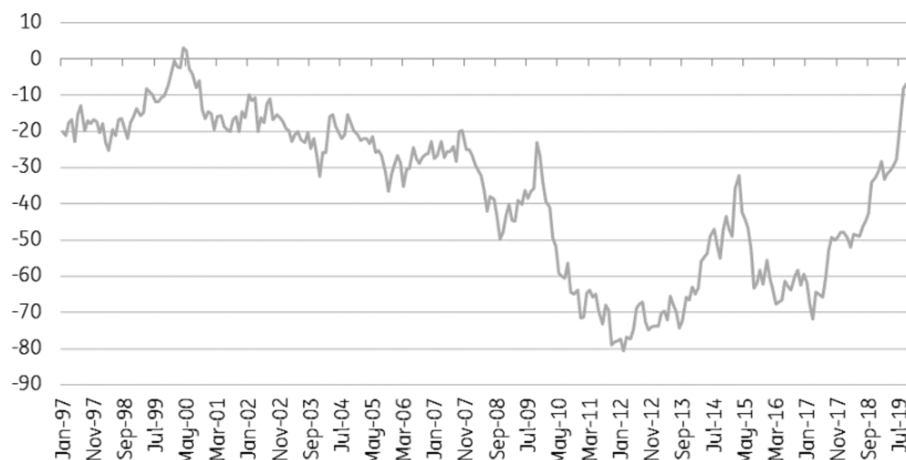
Data by Elstat shows Greek GDP expanded by 0.6% quarter on quarter in seasonally adjusted terms and by 2.3% year on year in non-seasonally adjusted terms.

As in 2Q19, the main driver was net exports, on the back of strong export performance and soft import growth. The latter likely followed poor fixed capital formation and soft private consumption growth. A puzzling pattern, given persisting global headwinds weighing on international trade flows.

Looking at consumer confidence, we would have expected stronger consumption data, but topping employment numbers over the summer months might have tamed the positive impact of rising minimum wages and of the VAT-induced deceleration in inflation on disposable income. Gross fixed capital formation remains the soft spot in the Greek picture and the new Mitsotakis government seems well aware of its relevance.

With insufficient resources to rev up investment domestically, PM Mitsotakis seems to be eyeing foreign investors to kick start the process. The memorandum of understanding recently signed with Chinese president Xi to overcome obstacles to implement Cosco's investment plans in Piraeus port is a case in point.

Consumer confidence setting new highs: Will consumption follow?



Source: Refinitiv Datastream

Tax cuts to propel consumption, what about investments?

As promised during the election campaign, prime minister Kyriakos Mitsotakis is trying to implement his tax cut plans, in some cases in contrast with creditors' recommendations.

The plan foresees, among other measures, cuts to the personal income tax rate for the lowest bracket, an increase in the tax-free threshold for households with children and a reduction in the business tax rate. We expect that the combined effect of tax cuts and continued, if decelerating, improvement on the employment front will help to revive private consumption in the course of 2020.

We are less sure that they will be as effective in propelling private investment, as this might still suffer from unfavourable dynamics in bank credit (Greek banks are still burdened by a heavy load of NPLs) and of the incomplete implementation of structural reforms, whose completion will remain a tough challenge for the centre-right government.

Fiscal discipline continues to pay off

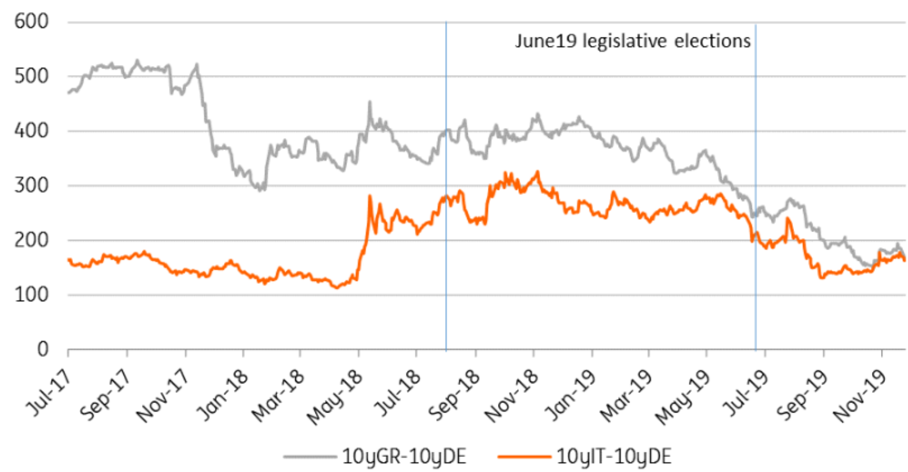
For the time being, the fiscal picture is following the post-programme expected path. Primary balance data released up to October suggests that Greece will again outdo the 3.5% of GDP post-programme target this year and the draft budget targets it at 3.7% for 2020.

As expected, the new Greek government chose not to challenge the post-programme targets in 2020; it might when it will discuss the 2021 budget draft, but we expect this to happen in a constructive way. Commitment to fiscal discipline is apparently being acknowledged by both markets and official lenders. Spreads of 10-year Greek government bonds on German bunds have fallen by some 100bps since the Mitsotakis government took office, and lenders have not turned a deaf ear to the Greek government requests for debt relief measures.

Upon the consent of the ESM, in November, Greece paid back some €2.7 bn of its existing IMF loan, which was granted on much worse interest rate conditions than the ESM ones. On the same line, on 5 December the Eurogroup decided to return the profits made by European central banks on Greek government bond holdings as part of the SMP and ANFA programmes.

Having paid a high economic and social price for the consequences of the debt crisis, the Greek economy continues recovering, even if is at an unspectacular speed. We expect it to outperform the eurozone aggregate over our current forecast horizon.

Bond spreads show increasing confidence in debt sustainability



Source: Refinitiv Datastream

The Greek economy in a nutshell (%YoY)

	2018	2019F	2020F	2021F
GDP (%)	1.9	2.0	2.0	1.7
Private consumption (%)	1.0	0.3	1.3	1.3
Investment (%)	-12.0	2.2	3.9	4.3
Government consumption (%)	-2.5	1.8	0.2	2.1
Headline CPI (%)	0.8	0.4	0.5	1.0

Source: Datastream, all forecasts ING estimates

Belgium: A year later, the stand-off continues

Philippe Ledent
Senior Economist, Belgium, Luxembourg
+32 2 547 3161
philippe.ledent@ing.com

Political negotiations remain at an impasse a year after the government resigned in Belgium. This hasn't seemed to have had a massive impact on the economy for now, mainly supported by household consumption... but for how long?

Political deadlock

Belgium has been with a caretaker government for more than a year and without a majority in parliament. Following the elections, the political negotiations have not led to a new majority at the federal level, so the caretaker government is still in place. To be sure, regional governments have been set up, but their fiscal power remains modest. As a result, economic policy is on hold.

At this stage, three scenarios remain possible: first, a broad coalition excluding extremist or nationalist parties could be formed. Secondly, a coalition of Flemish nationalists and French-speaking socialists (the largest parties in the North and South of the country) associated with other parties could also be possible, even if at this stage, those parties are not ready to work together. Third, a return to elections is still possible. In any case, no scenario offers a clear direction for economic policy in the coming years. Given the state of progress of the discussions, it is very unlikely that Belgium will end 2019 with a federal government.

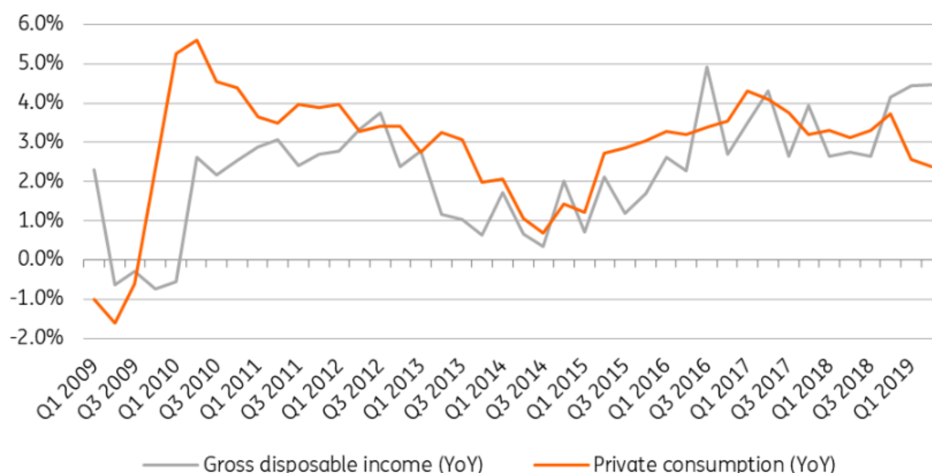
Economic resilience

Given the weak global economic context and the political crisis, domestic demand is proving to be surprisingly resilient and has helped to offset the weak performance of international trade.

An acceleration in household consumption expenditure is even observed, after being atone for long. In the third quarter of 2019, private consumption rose by 1.5% year-on-year, in a context where households confidence remained stable and their intentions to buy durable goods even increased. This can be explained by the recent acceleration in household disposable income.

Driven mainly by relatively dynamic employment growth (+70,000 jobs in 2018, +48,000 jobs in the first three quarters of this year), nominal income rose by almost 4%. Knowing that at the same time inflation has fallen sharply (see below), this leaves room for an increase in real disposable income that has been sufficient to both significantly increase the savings rate and stimulate household consumption.

Disposable income is sufficiently solid to improve consumption and the saving ratio



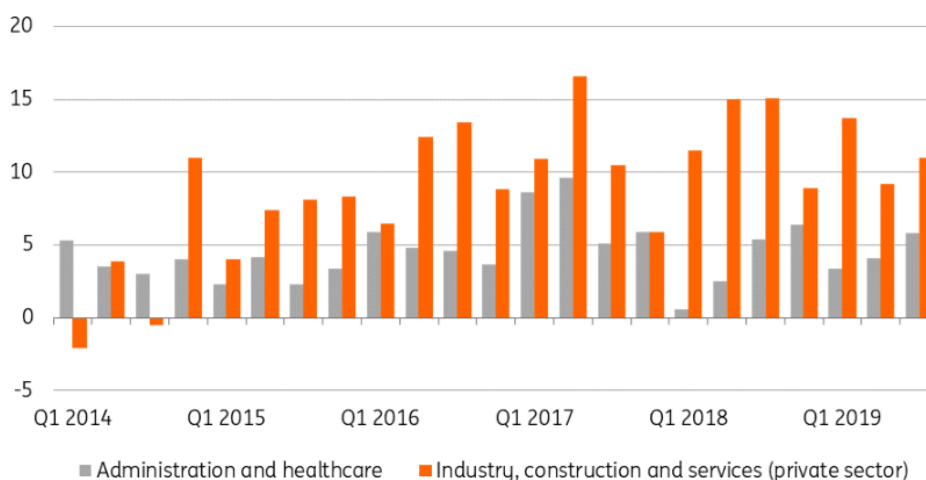
Source: National Bank of Belgium

For 2020, we remain cautious

On the one hand, the global economic growth that is expected to be rather low in 2020 will continue to weigh on activity exposed to international trade, even if a possible trade agreement between China and the United States will give some relief to exporters. On the other hand, it is unlikely that the Belgian economy will continue to create as many jobs as over the last years. Indeed, economic dynamics do not justify it.

At the same time, the lack of skilled workers will become increasingly acute. According to the ECB's SAFE survey on SME financing, the lack of skilled staff is by far the most pressing problem facing Belgian SMEs. Finally, when a federal government takes office (considering that it will take place in 2020...), the fiscal reality it will face requires it to take a series of cost-saving measures to correct the budget trajectory. This will have a negative impact on economic growth.

Job creation remains strong in the private and the public sector (thousand jobs)



Source: National Bank of Belgium

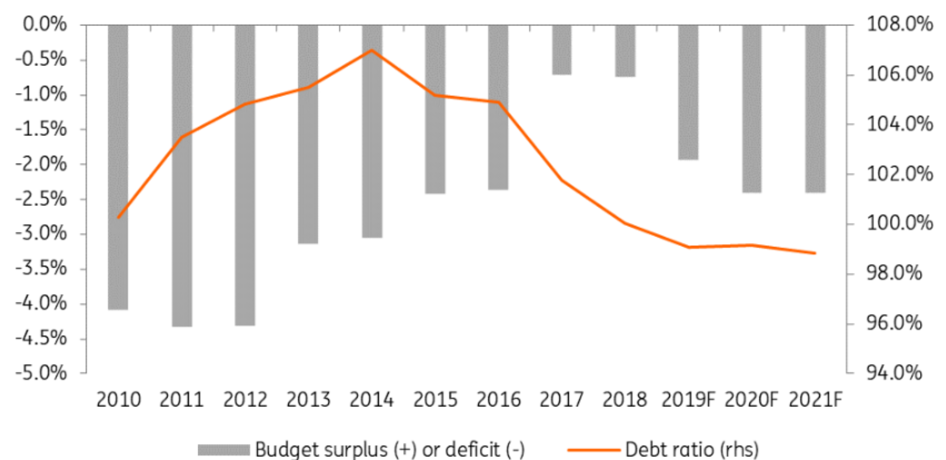
Public finance problem

Indeed, the state of public finances will require the next federal government to embark on a relatively large fiscal consolidation exercise. The absence of a government for the past year de facto implied the extension of the budget in force in 2018. Therefore, no further effort has been made, while a structural correction of 0.6 percentage points of GDP is requested by the European Commission.

In addition, the regional governments set up in 2019 all expect their (regional) deficits to increase in 2020, in order to finance new policies or investments. Without a federal government to coordinate budgets, the fiscal slippage may be significant once the figures are consolidated. This is all the more the case since, in the federal parliament, alternative majorities are formed to free up additional budgets for specific problems. Without coordination, these practices can have a significant long-term impact on the budget. At this stage, we fear that Belgium's budget deficit will indeed increase to 2.0% in 2020.

Fortunately, this should not compromise the reduction of the debt ratio, which should fall below 100% in 2020. But without a government, the situation will only get worse.

Debt ratio continues to decline despite the budget deterioration (% of GDP)



Source: National Bank of Belgium

Very moderate inflation

After a long period of inflation above the European average, inflation in Belgium has fallen sharply. In November, it was only 0.4%, while at the beginning of 2019, it was still close to 2%. However, this figure remains highly dependent on energy prices and therefore on oil prices. Indeed, core inflation remains broadly stable at around 1.5%. The same should be true in 2020.

To conclude, the year 2020 looks bleak. The external economic context, which is crucial for the dynamics of activity in Belgium, could improve temporarily thanks to a trade agreement between China and the United States. But at the same time, economic activity is expected to remain modest in Belgium's main trading partners (Germany, France, the Netherlands) and domestic demand is likely to suffer both from a slowdown in the labour market and from savings measures on the budget.

After growing by 1.3% in 2019, we expect economic activity to grow by 0.7% in 2020.

The Belgium economy in a nutshell (%YoY)

	2018	2019F	2020F	2021F
GDP	1.5	1.3	0.7	1.1
Private consumption	1.5	1.1	0.8	0.9
Investment	4.0	3.7	1.4	1.3
Government consumption	0.9	1.9	0.8	0.5
Net trade contribution	-0.7	-0.1	0.0	0.1
Headline CPI	2.1	1.4	1.3	1.5
Unemployment rate	6.0	5.5	5.4	5.3
Budget balance as % of GDP	-0.7	-1.9	-2.4	-2.4
Government debt as % of GDP	100.0	99.1	99.1	98.8

Source: Refinitiv Datastream, National Bank of Belgium. All forecasts ING estimates

Austria: Modest, but stable

Inga Fechner
Economist, Germany, Austria
+49 69 27222 66131
inga.fechner@ing.de

Austria's economy lost momentum during the course of 2019 given the challenging global environment. With domestic consumption and construction serving as growth drivers, we expect the economy to remain on a solid but slower growth path ahead

Strong growth years have come to an end

The strong growth years which the Austrian economy experienced between 2016 and 2018 have come to an end thanks to the international economic slowdown,

After strong first-quarter GDP growth of 0.5%, the Austrian economy lost momentum during the course of 2019 as growth slowed to 0.1% in Q2 and Q3.

Robust domestic consumption, employment, wage and salary growth, as well as the construction sector, have been growth drivers. Also investment started off the year with lots of momentum but has gradually slowed down over the course of the year. Thanks to Austria's diversified economic sector and trade structure, global headwinds have been less severe than in other European countries.

Nevertheless, with the slowdown in the global economy and particularly the German economy, recent GDP growth figures show that the Austrian economy could not remain an island of indefinite growth. Overall, the economy is likely to have grown by 1.6% in 2019 compared to the previous year; which is still faster than many other eurozone economies.

Politicians have been in a generous mood

Although the government consisting of the Austrian People's Party (ÖVP) and the Freedom Party (FPÖ) parted ways in May 2019 due to a political scandal, a number of legislative resolutions, including first parts of the ÖVP/FPÖ's planned tax reform, pension adjustments and a digital tax were passed by the former and by the transitional government, therefore private consumption should remain strong in the next years.

The total volume of the tax reform package is estimated to cost €2.8 bn, while revenues of €0.8 bn are expected. These expenses had been already foreseen under the former government, while expenses for the pension adjustment, however, will cost an additional amount of €1.8 bn and will likely be a drag on the Maastricht balance. Also, the economic slowdown is likely to ultimately affect the fiscal room for manoeuvring for future governments.

Coalition talks ongoing

Currently, coalition talks between the ÖVP and the Green party on forming a new government coalition are ongoing and could last until Christmas or even into the new year. The Green party did not make it into parliament in the 2017 election but made a stunning comeback in the 2019 election securing 13.9% of votes.

Aside from the Green party, coalition options are limited for the ÖVP – the FPÖ has excluded itself from coalition talks, a coalition with the liberal NEOS is not possible from a mathematical point of view, while the ÖVP and the Social Democrats are extremely different in terms of party programmes – there are still major differences between the ÖVP and the Green party in terms of climate protection in association with a CO2 minimum price, or regarding migration and asylum.

If coalition talks prove to be successful, expect more climate-focused investments although any room for manoeuvring will be limited.

Economic growth to remain modest

Seeing that the global environment will remain challenging also in 2020, economic growth is expected to remain modest but should regain some momentum in 2021.

The Austrian economy in a nutshell (% YoY)

	2018	2019*	2020*	2021*
GDP	2.4	1.6	1.1	1.4
Private consumption	1.2	1.6	1.4	1.4
Investment	3.9	2.9	2.1	1.9
Government consumption	0.9	0.2	1.1	0.8
Net trade contribution	0.9	0.0	0.2	0.2
Headline CPI	2.1	1.6	1.8	1.8

Source: Refinitiv Datastream, all forecasts ING estimates

Portugal: Economy to slow but the fiscal picture should improve

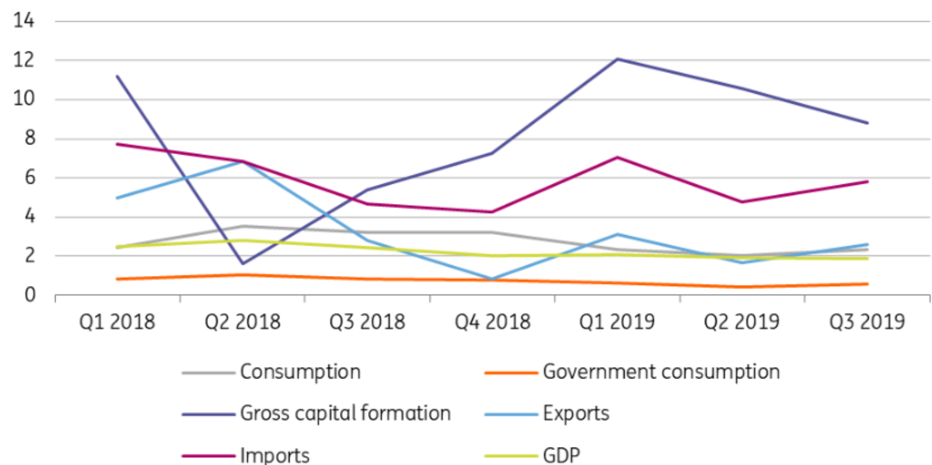
Steven Trypsteen
Economist, Spain and Portugal
+32 2 547 3379
steven.trypsteen@ing.com

The Portuguese economy continued to slow in 2019 and we don't really expect things to change much in 2020. Even though the country has a minority government yet again, we don't expect serious political problems ahead. However, expect the fiscal picture to improve

Economic growth slowed further in 2019, but the country still remains one of the better performers within the eurozone.

The slowdown is mainly due to weaker private and government consumption and investment growth. Even though these components are less dynamic, they remain the main growth drivers. Export growth remained decent over the course of the year, but at a lower level than in 2018. Import growth, on the other hand, continued to grow at a much faster pace. This implied that the net trade contribution was strongly negative in 2019.

Consumption and export growth eased in 2019 (YoY growth)



Source: Refinitiv Datastream

Looking ahead, we expect the economy to slow further in 2020.

We see two main reasons for this. First, we think that consumption growth will ease further. The unemployment rate stopped edging downwards since the end of 2018 and since then hovers around 6.6%. Consumption was, therefore, less supported in 2019. As overall hiring intentions didn't move much higher in recent months, we don't expect the unemployment rate to come down significantly soon. Second, investment growth is also bound to decelerate. It already slowed in 2019, but still remains at a high level. Moreover, capacity utilisation in the industry started to decline over the course of 2019, leading to less requirement for new investment.

The new minority government, led by the socialist António Costa, is expected to continue with prudent fiscal policy and so the high level of government debt as a percentage of GDP is expected to fall further in the years ahead.

During the election campaign before the October elections, Costa said that Portugal needs to stay on the path of fiscal consolidation in order to be stronger for potential storms ahead. As we expect the interest rate on Portuguese government debt will hover around current low levels in 2020, doing so will be easier.

We expect economic activity to slow to 1.4% GDP growth in 2020 and 2021, compared to 1.9% in 2019. The fiscal picture is expected to improve further.

The Portuguese economy in a nutshell (%YoY)

	2018	2019F	2020F	2021F
GDP (%)	2.4	1.9	1.4	1.4
Private consumption (%)	3.1	2.5	2.0	2.0
Investment (%)	6.1	4.3	2.5	2.5
Government consumption (%)	0.9	0.8	0.7	0.6
Net trade contribution (%)	-1.0	-0.1	-0.5	-0.5
Headline CPI (%)	1.2	0.4	0.7	1.2
Unemployment rate (%)	7.0	6.5	6.4	6.3
Budget balance (% of GDP)	-0.4	0.0	0.1	0.1
Government debt (% of GDP)	122.2	119.4	116.8	113.8

Source: Thomson Reuters, all forecasts ING estimates

Ireland: Brexit and future trading anxiety

Bert Colijn
Senior Economist, Eurozone
Amsterdam +31 20 563 4926
bert.colijn@ing.com

The Irish economy continues to grow at an exceptional pace, which is likely to become more modest over the course of 2020 as supply-side constraints, government spending and trade uncertainty bite

Brexit is set to move to phase 2, but uncertainty remains

The never-ending saga continues. Even though the UK election result does provide somewhat more of a stable path towards a structured Brexit, the UK departure from the EU can still result in widely varying outcomes for the Irish economy in 2020. Even though the front stop in the Withdrawal Agreement has brought some relief, Ireland is still dependent on UK trade and therefore the future trading relationship matters a great deal for the Irish economy.

The path towards a trade deal is short as the end of the transition period is already at the end of 2020. Experts say that a good free trade agreement is almost impossible to achieve in such a short time, but British prime minister Boris Johnson has said that he will not extend the transition period by another two years. As the Conservatives have won a comfortable majority, it seems electorally possible for him to change his mind on this matter, but does he want to is the real question. If the transition period is extended, this would take away economic uncertainty and rule out a cliff-edge Brexit, which for now still remains a possibility.

Regardless, with this election result “Remain” is now almost certainly off the table, which means that Ireland will start to see some negative effects on its economy from Brexit being put into motion.

A red hot economy, set to moderate

But let’s not overestimate the Brexit impact either. Growth rates in Ireland have remained stellar over the past few years despite Brexit uncertainty. Of course, impacted by activities from multinationals operating in Ireland, but the alternative modified domestic demand figures also show continued strength in the domestic economy stripped from multinational activity. In the third quarter, Irish GDP grew by 1.7% quarter-on-quarter, outpacing all other eurozone economies. Modified domestic demand even

grew by 3.6% q-o-q, which shows that growth in the Irish economy is not just determined by volatile multinational capital flows.

Local investment, mainly in construction, has continued to improve despite Brexit uncertainty. This makes sense given the housing shortages that Ireland faces. Supply problems are shrinking due to the ongoing construction sector investment, but are not expected to meet demand in the coming year. Shortages and low-interest rates are therefore likely to underpin ongoing house price growth in 2020 albeit at a somewhat more modest pace.

"Growth rates in Ireland have remained stellar over the past years of Brexit uncertainty"

Household consumption has also maintained a healthy pace as the labour market continues to rapidly expand. Even though job growth contracted in the second quarter, this is more of an anomaly than a trend. The unemployment rate stands at just 4.8% in October, far below the eurozone average and providing a strong indication that Ireland is at full employment. Still, vacancy rates are well below the eurozone average, partly because of an influx of immigrants to Ireland as the economy continues its recovery. Since early 2015, the amount of non-Irish citizens in the Irish labour market have increased by 27%, which alleviates some of the labour market pressures seen in Ireland.

Still, it is likely that labour market constraints become more visible in the Irish economy over the course of 2020, curbing growth in domestic demand. On top of that, government spending will be contractionary according to the budget proposal for 2020 as the Irish government has worked on the assumption of a no-deal scenario. As this is unlikely to emerge, spending can be considered conservative over the course of the year. Not that the economy needs stimulus, but it will add to an overall picture of a red hot economy cooling off in 2020.

The Irish economy in a nutshell (% YoY)

	2018	2019F	2020F	2021F
GDP (%)	8.3	5.4	2.2	2.6
Private consumption (%)	3.4	3	2.2	2
Investment (%)	-21.1	41.5	3.4	3.8
Government consumption (%)	4.4	4.2	3.1	1.8
Net trade contribution (%)	15.4	-5.6	-0.3	-0.3
Headline CPI (%)	0.8	0.9	1.1	1.3

Source: Macrobond, all forecasts ING estimates

Finland: Better than others, but far from immune to a slowdown

Bert Colijn
Senior Economist, Eurozone
Amsterdam +31 20 563 4926
bert.colijn@ing.com

Don't let those rosy numbers fool you, the Finnish economy is battling structural problems and political uncertainty

2019 exceeds expectations

The Finnish economy continues to outgrow the eurozone average. In fact, with 0.7% growth in the third quarter, Finland has maintained its position as one of the strongest growing economies in the eurozone this year. Revisions to the second quarter caused annual growth in GDP to accelerate substantially to 2.2%. Strength in domestic demand has been the main driver behind the decent growth numbers as household consumption and investment both grew by more than 1% in the third quarter.

Strength in household consumption comes as a slight surprise given the relatively slow growth in wages and shrinking employment in the third quarter. Unemployment has not yet turned higher, indicating that labour market resilience remains decent for the moment, but it will be difficult to maintain this fast-paced household consumption growth without support from the job market.

Strong domestic demand has also impacted net exports, as imports grew far quicker than exports in the third quarter. The export environment has become less benign globally and Finland is not immune to this. Export growth has slowed substantially over the course of 2019 and while growth to trade partners outside the EU had been faster, both intra- and extra-EU trade growth have declined to around 0% year-on-year. Out of the larger Finnish trade partners, China has seen the largest decline with a drop of 17.5% year-on-year in exports in goods in September. The US saw a large decline in August after which exports in goods bounced back.

This growth pace is hard to maintain next year

Looking ahead to 2020, growth is likely to be curbed further as the export environment continues to be plagued by trade war concerns. Moreover, limits to employment growth are likely to subdue domestic demand growth. Even though we expect some

moderation regarding the trade outlook, uncertainty will likely remain for some time to come. As many of Finland's largest export partners are directly or indirectly suffering from increased tariffs, this will negatively impact the trade outlook for Finland in the year ahead.

Domestic demand is set to be subdued over the course of next year, even though it is expected to contribute positively to growth, as employment growth has slowed while investment tends to moderate in times of uncertainty. The employment outlook is modest at best as labour shortages have been increasing while aggregate labour demand has been softening. This means that mismatches in the labour market are curbing potential, which in turn has an impact on the potential for household consumption growth over the course of the year. Wage growth is set to improve though, which counters some of the negative labour market impact from weaker job growth.

Political uncertainty is likely to simmer in 2020

Government spending will provide some tailwind to growth over the coming years as the 2020 budget submitted by the new government foresees increased spending. The impact will likely be modest though as the cyclically-adjusted budget balance is only modestly increasing for 2020. Finland does not have that much fiscal room though, making it difficult to generate a lot of fiscal stimulus in the coming years. In fact, even though Finland is projected to remain below the 60% debt-to-GDP threshold, the European Commission sees the risk of significant deviation from the path towards the medium-term budgetary objective, meaning that if anything, fiscal prudence is requested by Brussels.

The new government has been off to a tumultuous start as Prime Minister Antti Rinne has had to step down following the handling of a strike at the postal service which spread to other sectors. The government has been quick to pick a successor, which means that new elections have been avoided at a potentially embarrassing time as Finland holds the EU presidency. Current transport minister Sanna Marin has become the new prime minister having received approval from parliament. The SPD's four coalition partners have agreed to support her, which means that the coalition can continue despite a significant rift between the parties.

Marin will have an important task ahead of her to mend the problems between the partners, or new elections could loom once more. This would not be in any of the coalition partners' interests though as polls have not exactly developed favourably for the current coalition. The opposition parties – most notable the Finns Party – have gained ground since the start of the coalition, making it risky to pull the plug on the current government. Still, if differences cannot be overcome, the chances of a new general election do increase. This means that political risk surrounding Finland will remain modestly elevated at the start of 2020.

The Finnish economy in a nutshell (% YoY)

	2018	2019F	2020F	2021F
GDP (%)	1.7	1.6	1.2	1.1
Private consumption (%)	1.8	1.5	1.2	1.2
Investment (%)	3.3	0.6	0.5	0.3
Government consumption (%)	1.5	1.1	2.2	1
Net trade contribution (%)	-1	0.1	-0.2	-0.2
Headline CPI (%)	1.2	1.1	1.4	1.5

Source: Macrobond, all forecasts ING estimates

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (**"ING"**) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies). The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is subject to limited regulation by the Financial Conduct Authority (FCA). ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit https://www.ing.com.