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European Economic Forecast

Winter 2024

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EUROPEAN ECONOMY

#EURO at 25

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European Commission
Directorate-General for Economic and Financial Affairs

European Economic Forecast

Winter 2024 (Interim)

EUROPEAN ECONOMY

Institutional Paper 268

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A DELAYED REBOUND IN GROWTH AMID FASTER EASING OF INFLATION

This Winter interim Forecast lowers the growth outlook for this year and sets inflation on a lower downward path than projected last autumn. Economic activity in 2023 is now estimated to have expanded by only 0.5% in both the EU and the euro area. The growth outlook for 2024 is revised down to 0.9% in the EU and 0.8% in the euro area. In 2025, economic activity is still expected to expand by 1.7% in the EU and 1.5% in the euro area. EU HICP inflation is forecast to fall from 6.3% in 2023 to 3.0% in 2024 and 2.5% in 2025. In the euro area, it is projected to decelerate from 5.4% in 2023 to 2.7% in 2024 and to 2.2% in 2025.

Last year's modest growth largely owes itself to the momentum of the post-pandemic economic rebound in the previous two years. Already towards the end of 2022, the economic expansion came to an abrupt end and activity has since been broadly stagnating, against the background of falling household purchasing power, collapsing external demand, forceful monetary tightening and the partial withdrawal of fiscal support in 2023. The EU economy thus entered 2024 on a weaker footing than previously expected. After narrowly avoiding a technical recession in the second half of last year, prospects for the first quarter of 2024 remain subdued.

Still, there have been positive developments since the 2023 Autumn Forecast, particularly when it comes to inflation. The sharp fall in energy prices was followed by a broad-based and faster-than-expected moderation of price pressures. As energy supply keeps outstripping demand, spot and future prices for oil and especially gas are now significantly lower than assumed in the Autumn Forecast. Retail energy prices are therefore set to fall further, helping EU recover some of the competitiveness lost during the energy crisis. Despite mild upward pressure from higher shipping costs in the wake of Red Sea trade disruptions, underlying inflation continues on a steady downward path. Credit conditions are still tight, but markets now expect the loosening cycle to start earlier. Remarkably, the EU labour market continues to perform strongly.

All in all, the conditions for a gradual acceleration of economic activity this year appear to be still in place. As inflation decelerates, real wage growth and resilient employment should support a rebound in consumption. Despite falling profit margins, investment is set to benefit from a gradual easing of credit conditions and further deployment of the Recovery and Resilience Facility (RRF). The pace of growth is set to stabilise broadly in line with potential, as of the second half of this year.

Protracted geopolitical tensions and the broadening of the Middle East conflict to the Red Sea tilt the balance of risks towards more adverse outcomes. Additional trade disruptions could bring renewed stress to supply chains, hampering production and adding price pressures. Domestically, a faster recovery of consumption, higher-than-expected wage growth and a lower-than-anticipated fall in profit margins could hold back the disinflation process. On the downside, a more persistent transmission of the still tight monetary conditions could further delay the rebound in economic activity, pushing inflation lower. Climate risks and the increasing frequency of extreme weather events continue to pose threats.

Table 1:
Overview - the Winter 2024 interim Forecast

	Real GDP growth						Inflation					
	Winter 2024 interim Forecast			*Autumn 2023 Forecast*			Winter 2024 interim Forecast			*Autumn 2023 Forecast*		
	2023	2024	2025	*2023*	*2024*	*2025*	2023	2024	2025	*2023*	*2024*	*2025*
Euro area	0.5	0.8	1.5	*0.6*	*1.2*	*1.6*	5.4	2.7	2.2	*5.6*	*3.2*	*2.2*
EU	0.5	0.9	1.7	*0.6*	*1.3*	*1.7*	6.3	3.0	2.5	*6.5*	*3.5*	*2.4*

1. EURO AREA AND EU OUTLOOK

1.1. SETTING THE SCENE

The broad stagnation of the EU economy throughout 2023 carried over into weak momentum entering the new year. The EU economy narrowly escaped a technical recession (two consecutive quarters of contracting GDP) in the second half of 2023, and at the end of the year real GDP was broadly at the same level as in the third quarter of 2022. Consumption and investment barely moved, underperforming expectations, while the weak positive contribution to growth of external demand was driven by imports falling more than exports. The drawdown of inventories also weighed on growth, potentially reflecting a still on-going post-pandemic rebalancing of supply and demand. The EU economy thus entered 2024 on a weaker footing than previously expected, and the latest high frequency indicators do not suggest an imminent rebound. The contraction in manufacturing activity appears to have bottomed out and recent confidence readings are on an upward trend but remain below their long-term averages.

The disappointing growth performance in 2023 must be assessed against the background of high, albeit declining, inflation and tightening monetary policy. In the fourth quarter of 2022, inflation in the EU peaked at 11%, with inflation in the euro area a notch below. One year later, between October and December 2023, EU inflation averaged 3.4%. The remarkable drop in inflation was largely driven by falling energy inflation (fuel, gas and electricity), as the EU successfully weaned itself off its dependency on Russian gas. Starting last summer, the slowdown of inflation in food (see Box 1.4), non-energy goods and services was also remarkable. Especially for the last two categories, it owes much to the vigorous tightening of monetary conditions: in the 15 months between July 2022 and September 2023, the ECB raised policy rates by a cumulative 450 basis points. This was the fastest tightening cycle in the history of the euro area. The tightening was even more forceful in some non-euro area Member States. Notwithstanding the rapid fall of inflation, price growth outstripped nominal wage growth for several quarters, eroding households' purchasing power and wealth (see Box 1.3) and weighing on consumption growth. Though the corporate sector has weathered the successive shocks of the pandemic, surging energy prices and rising labour costs (see Box 1.2), tighter credit conditions have put a lid on investment growth – especially in construction. On the positive side, the labour market showed resilience, dispelling fears that policy action to tame inflation would come at the cost of employment losses.

Though global growth outside the EU held up relatively well, trade developments were disappointing last year. Economic activity outside the EU continued to grow steadily in 2023, but trade growth was anaemic. While services trade expanded further, global merchandise trade is estimated to have contracted, weighing heavily on the open EU economy. This weakness in merchandise trade in 2023 reflected a combination of the post-pandemic pullback in demand for consumer goods, tight financing conditions that held back demand for investment goods and increasing trade fragmentation in a context of heightened geopolitical tensions.

Beyond the short-term weakness, the macroeconomic environment is set to become more supportive of growth. Energy prices continue to benefit from ample inventories and strong supply and have so far reacted only marginally to the threat of supply disruptions posed by the conflict in the Middle East. Except for a short-lived uptick in January this year, wholesale prices of oil and gas have continued to fall and are now well below the assumptions underpinning the Autumn 2023 Forecast (AF23), heralding further contraction in retail energy prices in most EU countries, and supporting a further recovery in the EU's external competitiveness, battered by the energy crisis in 2022. Although credit conditions are set to remain tight, falling inflation has fuelled market expectations of an imminent turnaround in the monetary stance. As a result, financial conditions are now somewhat looser than in autumn. With little evidence that the labour market performance has reached a turning point and in a context of decelerating inflation, real wage increases continue to presage a rebound in consumption. Demand from EU trading partners is also set to pick up vigorously this year.

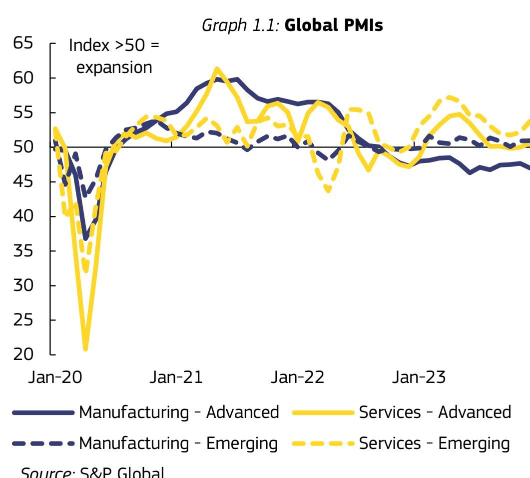
Further escalation of geopolitical tensions warrants particular attention as the EU is less insulated from global developments than other large economies. This forecast assumes that geopolitical tensions will remain elevated throughout the forecast horizon. Though sanctions against Russia are expected to remain in place, the conditions for a gradual increase in reconstruction efforts in Ukraine are assumed to already be met as from end-2024/early 2025. This forecast likewise assumes that tensions in the Middle East will persist. The increase in shipping costs in the wake of the Red Sea trade disruptions is estimated to have a marginal impact on inflation. As firms adjust in response to delivery delays, they are assumed to avoid the supply bottlenecks that choked production and pushed up prices during the post-pandemic rebound (see Box 1.1).

1.2. THE GLOBAL ECONOMY: RECENT DEVELOPMENTS AND OUTLOOK

Global growth (excluding the EU) held up well throughout the first three quarters of 2023… After growing by 1% in the first quarter and 0.7% in the second, real GDP is estimated to have expanded by 0.9% q-o-q in the third quarter of 2023. The acceleration in 2023-Q3 was driven by stronger data for China and the US, while economic activity in other advanced economies (e.g. UK, Canada, Japan) slowed down. As a result, growth for advanced economies on aggregate decelerated slightly in 2023-Q3, to just above 0.4% q-o-q. Growth in emerging markets outside of China edged up to 1.1% (from 1% in 2023-Q2).

…and continued to expand in the fourth quarter. GDP data for 2023-Q4 came in broadly as expected in China and better than anticipated in the US. While fourth quarter GDP data for other economies is not yet available, the global composite PMI, at 50.5, points to continuing growth in 2023-Q4. The global services PMI weakened in 2023-Q4 but is still pointing to expansion. Yet, the global PMI for manufacturing remained in contractionary territory in 2023-Q4, at 48.9 and a little weaker than reported for 2023-Q3. The PMIs for manufacturing in advanced economies were particularly subdued (at 47.4). For both services and manufacturing the readings for emerging markets were somewhat stronger than for advanced economies.

Graph 1.1: **Global PMIs**



Source: S&P Global.

Weakness in global manufacturing is reflected in the sharp drop in global goods trade in 2023, while services, particularly travel and tourism, continued to recover. Growth in goods trade (excluding the EU) is estimated to have contracted in 2023 under the impact of the post-pandemic pullback in demand for manufactured goods, the weakness of the manufacturing sector and high inventories in the advanced economies, and fragmentation of trade due to geopolitical tensions. However, momentum for merchandise trade (measured on a 3m-on-3m basis) picked up slightly towards the end of the year. In contrast, global trade in services outpaced GDP growth in 2023, with a continued rebound in global travel and tourism, which recovered to around 90% of pre-pandemic levels.

Developments in the Red Sea are disrupting trade routes for goods. The re-routing of vessels via the Cape of Good Hope in South Africa resulted in the sharp fall of cargoes passing through the Red Sea. This is pushing up shipping rates and may act as a drag on global trade. See Box 1.1 for an assessment of these developments and their potential impacts.

Growth in the US has proved stronger than expected for 2023 on the back of robust private consumption, but is projected to moderate in 2024. The US economy accelerated in 2023-Q3 and remained strong in 2023-Q4 and growth for the year reached 2.5%, compared to 1.9% in 2022. Private consumption was the main growth driver, but other components of domestic demand – including government consumption and investment – also contributed. While core services inflation (i.e. services excluding housing) has proved persistent to date, decreasing housing (shelter) and energy price inflation is expected to support

the disinflation process in 2024. Since December, the US Federal Reserve has been signalling the end of policy rate increases and the intention to start cutting in the course of 2024. This prompted the benchmark US 10-year treasury yield to drop from close to 5% at the end of October 2023 to around 4% at the end of January 2024. In 2024, private consumption and investment growth are forecast to moderate due to a gradually cooling labour market, still-tight credit conditions, and the fiscal stance becoming less supportive. Because of a high carry-over effect for 2024, and in light of strong high-frequency indicators so far this year, US growth is now expected to reach 2.1% in 2024, higher than projected in the Autumn Forecast, and to expand at close to the potential growth rate of around 1.8% in 2025.

For the other advanced economies, growth is forecast to soften a little in 2024 and pick up again in 2025, though prospects vary by country. The Japanese economy has slowed down markedly in recent months, and growth in 2024 and 2025 is expected to be somewhat lower than in 2023, with softer private consumption, trade and investment. In 2024, the UK is projected to grow at a similarly slow pace as in 2023 as tight fiscal and monetary policy largely offset the boost from lower energy prices, before seeing some recovery in 2025. Developments elsewhere are mixed, with some economies expected to see slightly faster growth in 2024 (e.g. Taiwan, Singapore, Korea, Switzerland), while others are set to see a mild slowdown (e.g. Norway, Australia).

Burdened by the ongoing property sector downturn and adverse structural factors, China's economy is expected to slow down over the forecast horizon. Domestic demand in China remains weak as the real estate crisis continues to weigh on household and corporate spending. High debt levels are weighing on state-owned enterprises, while also limiting the capacity for counter-cyclical intervention by local governments. Consumer price inflation has been negative in China since October 2023 and export prices have also fallen sharply, contributing to global disinflationary pressures. Growth in China is expected to moderate to 4.6% in 2024 (unchanged from the Autumn Forecast) and further to 4.4% in 2025 (-0.2 pps. compared to autumn).

Emerging Market Economies (EMEs) excluding China have shown surprising resilience despite global headwinds, with growth expected to edge up in 2024, and further in 2025. These economies have recorded relatively steady growth (1% q-o-q on average) over the past 4-5 quarters, despite the drag from tighter monetary policy and generalised weakness in manufacturing and global goods trade. The moderation in energy and food prices in 2023 and supportive fiscal policy helped support growth. Policy rates are considered to have peaked and bond yields have fallen back in recent months as inflation has continued to edge down. The outlook for 2024 is for slightly stronger growth in MENA countries and Sub-Saharan Africa, while in Latin America slower growth is projected for Brazil and Mexico, and a contraction in Argentina.

Overall, global growth (excluding the EU) is expected to weaken from 3.5% in 2023 to 3.3% in 2024 and to return to 3.5% in 2025. For 2024, this is slightly stronger than in the Autumn Forecast (+0.1 pps.), driven largely by higher projected growth in the US, and unchanged for 2025 (see Table 1.1). Growth in advanced economies excluding the EU is expected to fall from 2.2% in 2023 to 1.9% in 2024, before edging back up to 2% in 2025. Growth in emerging economies (including China) is forecast to be 4.2% in 2023, 4.1% in 2024 and 4.2% in 2025.

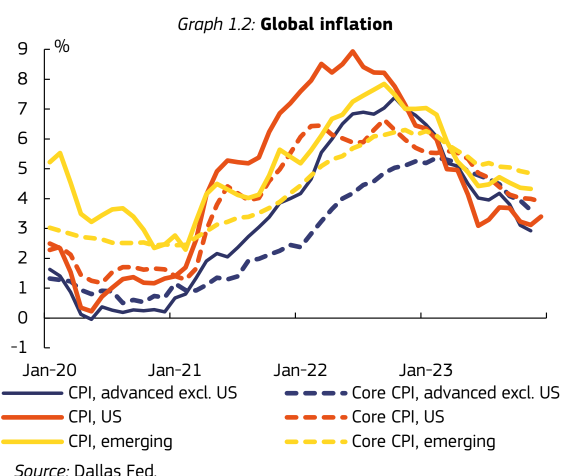
Global trade growth (excluding the EU) is expected to rebound in 2024 and 2025 after the low growth rates seen in 2023. Global goods trade started to show some signs of improvement at the end of 2023 and growth is set to gain traction this year, partly due to favourable base effects. The post-pandemic rotation of demand from goods to services has largely come to an end, while the manufacturing sector and demand for investment goods are expected to gain strength in 2024 and 2025 as headwinds from monetary tightening are set to ease gradually. There is also increasing evidence of a turn in the Information and communication technologies (ICT) cycle that would support exports of manufactures in electronics, particularly in Asia. Services trade is also set to continue its recovery. International travel remains below pre-pandemic levels, despite the improvement in 2023, with the shortfall concentrated in China and other Asian economies. Overall, these developments support the projected pick-up in trade elasticities with respect to GDP to around 1 in both 2024 and 2025.

Table 1.1:
International environment

(Annual percentage change)				Winter 2024 interim Forecast			*Autumn 2023 Forecast*		
	2020	2021	2022	2023	2024	2025	*2023*	*2024*	*2025*
				Real GDP growth					
World (excl.EU)	-2.5	6.3	3.3	**3.5**	**3.3**	**3.5**	*3.5*	*3.2*	*3.5*
				Trade volumes					
World (excl.EU) exports of goods and services	-7.0	10.7	3.2	**1.1**	**3.4**	**3.7**	*1.7*	*3.3*	*3.6*
World (excl.EU) imports of goods and services	-8.4	11.5	4.3	**0.2**	**3.5**	**3.7**	*1.2*	*3.4*	*3.7*

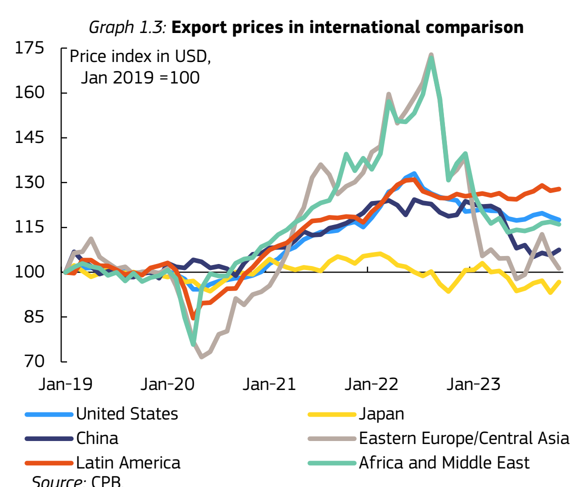
Concerns about persistently high global inflation appear to be dissipating. Both headline and core inflation rates have continued to fall in advanced and emerging economies (see Graph 1.2), though they remain above central bank targets in most cases. The further decline in oil prices in recent months and the marked weakness in Chinese export prices (see Graph 1.3) are expected to add downward pressure on headline rates. Higher shipping costs due to trade disruptions in the Red Sea are set to have a marginal impact on global inflation, but potential supply chain disruptions constitute upside risks.

Graph 1.2: **Global inflation**



Source: Dallas Fed.

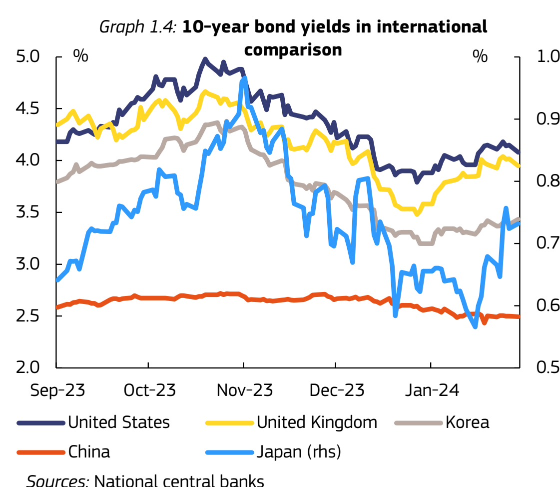
Graph 1.3: **Export prices in international comparison**



Source: CPB.

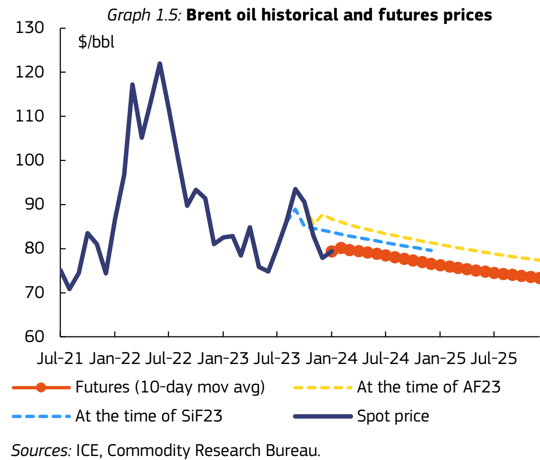
Global financial conditions have eased in late 2023, with a marked drop in bond yields across both advanced and emerging economies. The prospect of faster cuts in policy rates in the US and the subsequent fall in US bond yields spilled over favourably to global financial markets. The US dollar weakened broadly and long-term government bond yields fell, before recovering partially in January. Ten-year bond yields are down in many advanced and emerging economies over the past 2-3 months (e.g. UK, Canada, Brazil, India, South Africa, see Graph 1.4). In parallel, portfolio flows to emerging markets rose towards the end of 2023, after a dip during the summer months.

Graph 1.4: **10-year bond yields in international comparison**



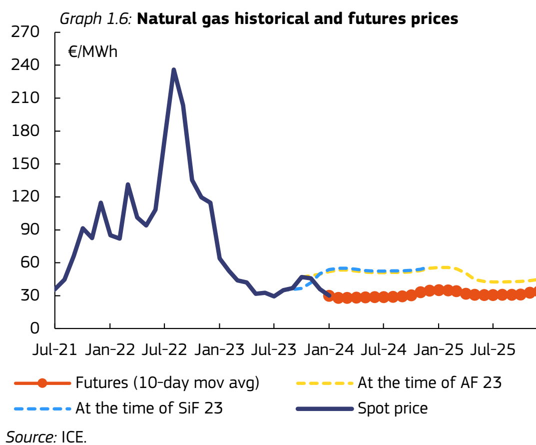
Sources: National central banks

Commodity markets have thus far shown little reaction to the mounting regional tensions in the Middle East. Crude oil prices have fallen since autumn, and futures prices indicate a further gradual decline in 2024 and 2025. Spot crude prices are now around USD 10/bbl lower than assumed in the Autumn Forecast, and futures prices at end-2025 are projected around USD 6/bbl lower (see Graph 1.5). The expected slowing of growth in the US and China is weighing on demand, while on the supply side, non-OPEC countries are offsetting attempts by the cartel to tighten the market. It is notable that OPEC's share of global oil output is now only 26.5% (as of December 2023), down from 33.5% a decade earlier, in 2013. Furthermore, internal discord has kept the cartel from finding a unified line on cutting supplies, possibly exemplified by Angola leaving the cartel at end-2023.

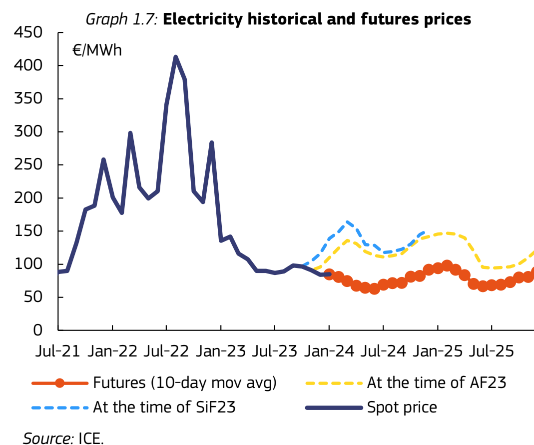


Sources: ICE, Commodity Research Bureau.

European gas and electricity prices fell strongly relative to autumn and are expected to remain broadly stable at current levels. Spot prices in 2023-Q4 turned out lower than previously expected (by 15% for both TTF gas and electricity, see Graph 1.6 and 1.7). TTF gas prices were just below EUR 30/MWh at the cut-off date and the futures curve remains flat around this benchmark until 2025-Q4, which would suggest a reduction of 46% in 2024 and 32% in 2025, compared to the expectations back in autumn. Mirroring gas prices, electricity prices are expected to be 30-40% cheaper over the forecast horizon. This decline reflects a combination of improved supplies and infrastructure (in gas as well as renewables, hydro and nuclear), very high gas inventory levels and subdued demand. Efforts to reduce natural gas demand resulted in the EU consuming 17% less in December 2023 (-19% for the January-November period) compared to the average for the month in the previous five years, partially achieved by a strong increase in new installed capacity in renewables in the power sector. The EU's exposure to energy price volatility has thus been contained, but the threat of disruption of LNG deliveries due to the conflict in the Middle East is a new risk.



Source: ICE.



Source: ICE.

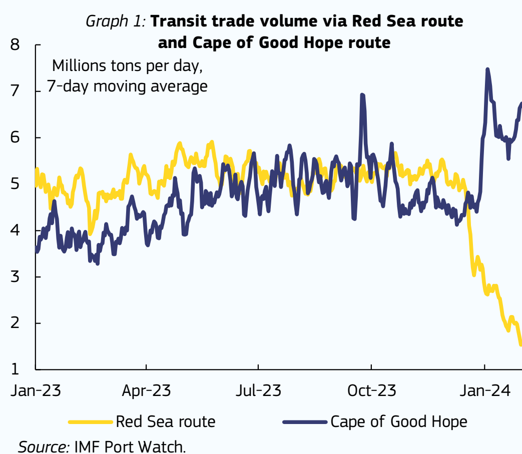
Food and metal prices are also well below previous peaks and are expected to edge down further. Food prices have slightly increased since autumn, but they are well below their peak in 2022, and futures prices continue to project a gradual decline over the forecast horizon. This comes on the back of an uptick in production of key markets for staple foods and reduced concerns over supply. Metal prices have also fallen and are expected to continue declining over the forecast horizon. The drop in prices is linked to weak economic activity in major advanced economies and weakness in China's commodity-intensive construction sector, as well as to ongoing supply recoveries for some base metals.

Box 1.1: **Impact of the Red Sea crisis on the EU economic outlook**

The Houthi rebels' attacks in the Red Sea are disrupting one of the major shipping routes for the global economy, affecting delivery times, shipping costs and supply chains. Approximately 12% of global trade volumes go through the Red Sea and the Suez Canal. This includes *inter alia* 30% of all container shipping, 12% of seaborne oil, 8% of seaborne liquid natural gas (LNG) and 8% of world grain trade. In 2022, around 23% of all EU goods imports came by ship from Asia, most of them travelling through the Red Sea. Disruptions in this key trading route may therefore have a significant impact on the EU economy. This box reviews the available evidence and concludes that – bar a significant escalation – companies should be able to avoid widespread production bottlenecks. Still, higher transport costs will inevitably be passed on to consumers, but the direct impact on inflation is set to be relatively small.

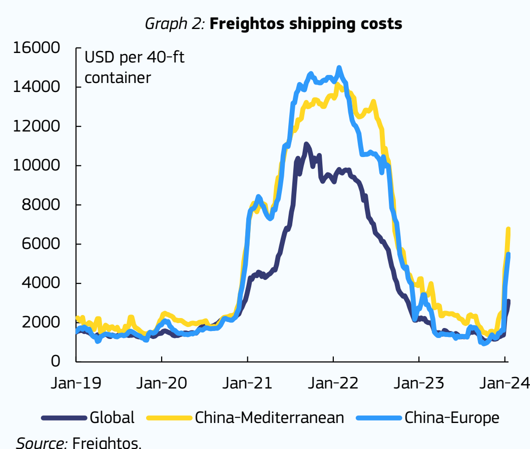
Shipping through the Red Sea has been re-routed, resulting in longer shipping times and skyrocketing shipping costs. Between the start of the attacks (19 October 2023) and end-January, the 7-day moving average transit trade volumes through the Red Sea fell by 70%, while trade volumes through the Cape of Good Hope increased by 30% (Graph 1). Shipping times between Asia and Europe increased by 10-15 days and freight costs for containers on several China to Europe routes increased by around 400%. The disruption is affecting shipping costs worldwide. Since the Autumn Forecast, the Freightos Global Container Freight Index – a weighted index of spot shipping freight costs along major routes – increased by 210% (Graph 2). ([1])

Graph 1: **Transit trade volume via Red Sea route and Cape of Good Hope route**



Source: IMF Port Watch.

Graph 2: **Freightos shipping costs**



Source: Freightos.

The impact on commodity markets has so far been limited. The increase in non-OPEC oil supply and high stockpiles in the US in a context of weak demand continue to prevail over trade disruptions. The same applies to gas, where high gas inventories and overall reduced demand in the EU continue to push the wholesale price of European gas (TTF) downward, despite the Red Sea representing an important artery for LNG shipments. Food and metal prices have also continued to moderate on the back of abating supply concerns and/or weak demand.

Firms in the EU are expected to manage the extension of delivery times without disruptions to output. According to the PMI survey, suppliers' delivery times in the US and in the euro area have increased for the first time since the winter of 2022 (Graph 3). Input prices, however, were broadly unaffected, while inventories of purchased goods remained at relatively high levels. According to the EU Business and Consumer Survey, in January industry managers reported that the role of shortages of material as a factor limiting production was either broadly unchanged (construction) or continued to decrease (industry), converging further towards the pre-pandemic long-term average. Capacity utilisation is also currently low (Graph 4). The Federal Reserve Bank of New York Global Supply Chain Pressures Index remained flat in January, after increasing in the prior months, and stood at about its long-term average. Available data suggest that neither global nor EU supply chains are currently under strain.

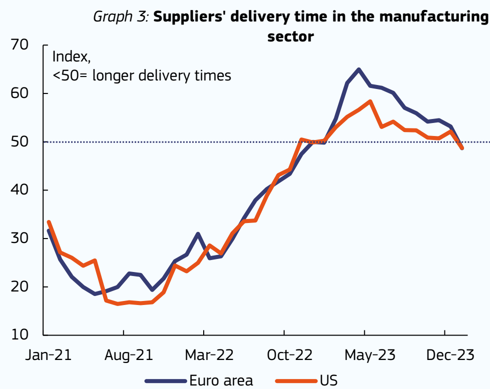
([1]) According to Freightos, the cost of freight from China to the US East Coast and West Coast increased by 180% and 160%, respectively.

(Continued on the next page)

Box (continued)

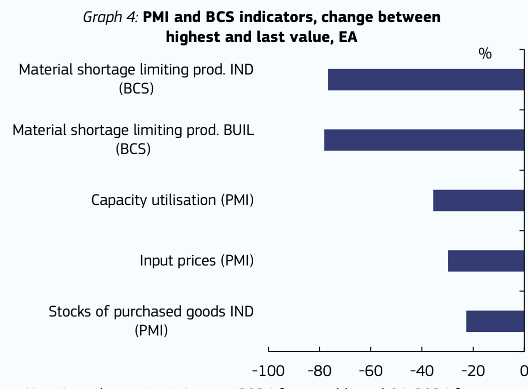
The freight market is also now significantly different than during the post-pandemic rebound and disruptions are set to be re-absorbed. The strong pullback of global demand for goods and tighter financial conditions have weighed heavily on global trade and the demand-supply imbalance that characterised the post-pandemic expansion has by now been reversed. Considering the glut in container and vessel capacity after the pandemic adjustment, shipping firms should progressively be able to absorb the shock of longer delivery routes. Firms may also use alternative vectors. In terms of price pressures, freight and insurance costs are typically low for most product categories, while land or air transport are often an alternative should shipping costs inflate excessively ([2]). The current surge in shipping costs is therefore set to be re-absorbed. As the supply overhang in vessels and containers prevails over the surge in delivery time, shipping prices are expected to fall back on their declining trend.

Graph 3: **Suppliers' delivery time in the manufacturing sector**



Source: S&P Global.

Graph 4: **PMI and BCS indicators, change between highest and last value, EA**



Note: Last data point is January 2024 for monthly and Q1-2024 for quarterly indices.
Source: S&P Global, European Commission.

Still, higher shipping costs are set to exert a limited upward pressure on inflation. Private sector analysts expect upward pressure on EU inflation to be in the range of 0.2-0.3 pps. ([3]). This range appears broadly plausible, considering recent estimates of pass-through of freight costs to headline inflation, the origin of EU imports and alternative scenarios of progressive normalisation in shipping costs as overcapacity in containers and vessels absorbs extended time at sea. The pass-through should be more visible in the second quarter of this year, after annual shipping contracts are agreed. The impact may be higher on those inflation categories which have higher import intensities, mainly industrial goods and certain food categories ([4]). In addition, the impact on inflation may be higher if shipping costs were to remain permanently higher and global demand were to pick up more strongly than projected. Further escalation is a clear risk for the economic outlook, in particular if the conflict disrupts energy supplies, causing oil and gas prices to surge.

([2]) Maritime transport costs are typically higher (above 5% of Freight On Board price) for low value to weight/volume products that are normally transported in bulk (e.g. crude oil, natural gas, grains) or require special conditions for transport (e.g. meat, vegetables and fruits, live cattle). Above a certain value to weight/volume, shippers switch to land or air transport. See Ferrari, E., P. Christidis and P. Bolsi. (2023). "The impact of rising maritime transport costs on international trade: Estimation using a multi-region general equilibrium model". *Transportation Research Interdisciplinary Perspectives Volume 22.*

([3]) JPMorgan estimates a 0.27 pps. add to global core CPI in response to a roughly 150% sustained increase in container shipping costs. ABN Ambro finds that the rise in shipping tariffs may raise euro area goods inflation by 1 pp. and overall inflation by 0.3 pps. Goldman Sachs suggests that the increases since December could raise global core prices by 11 bps., with larger effects in the euro area (0.21 pps.) and smaller effects in the US (6 bps.). The OECD estimated that a 50% rise in shipping costs increases import price inflation by 2 pps. and consumer price inflation by about 0.2 pps., after a year. *Sources:* JPMorgan (2024). *Shipping disruptions reignite supply chain woes*. Global Emerging Markets Research, January; ABN Amro (2024). *Will the Red Sea disturbances throw disinflation off track?* Global Monthly, January; Goldman Sachs (2024). Global Economics Comment: *Higher Costs Due to Red Sea Shipping Disruptions Imply Modest Upside to Global Inflation*. Economics Research, January; Organisation for Economic Cooperation and Development (OECD) (2021). "Rising container shipping costs could push up near-term inflation in OECD countries." In *OECD Economic Outlook*, Vol 2021 Issue 1, No. 109, pp. 31-33, May.

([4]) ECB (2022). "A new indicator of domestic inflation for the euro area." In *ECB Economic Bulletin*, Issue 4, Box 7.

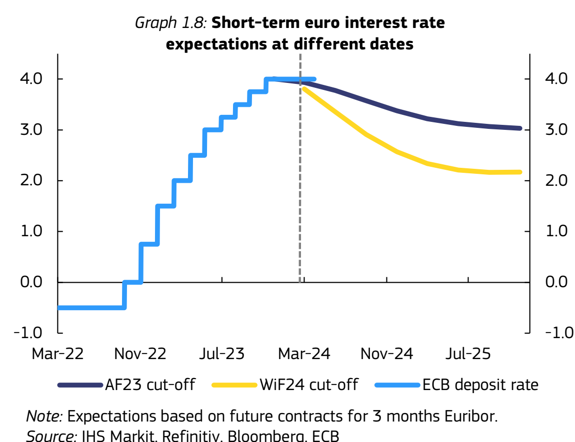
1.3. FINANCIAL MARKETS

Financial conditions have eased since the Autumn Forecast. This is mainly observed on bond markets, as the yield curve shifted downward and risk premia for both sovereigns and corporates declined slightly. Equity markets have equally registered a strong performance. The appreciation of the euro against the US dollar also contributes to falling financing costs of those corporations indebted in USD. By contrast, bank lending interest rates have not changed much during this period and lending volumes are close to standstill. However, a turnaround in the bank credit cycle seems to be approaching.

The ECB Governing Council held policy rates steady in January and dismissed speculation about imminent rate cuts. At its third meeting since September, the ECB maintained the interest rates on the main refinancing operations, marginal lending facility and deposit facility at 4.50%, 4.75% and 4.00%, respectively. The ECB reiterated its assessment that rates were at levels that, if maintained for sufficiently long, would make a substantial contribution to the timely return of inflation to 2%, which in the ECB's most recent economic forecast would only happen in late 2025. In their communication, board members continued to reiterate that any decision on rate cuts would be premature. Meanwhile, the size of the Eurosystem's balance sheet continues to decline, as maturing securities held in the Asset Purchase Programme have not been reinvested, while banks have repaid EUR 100 bn of TLTRO loans ([1]).

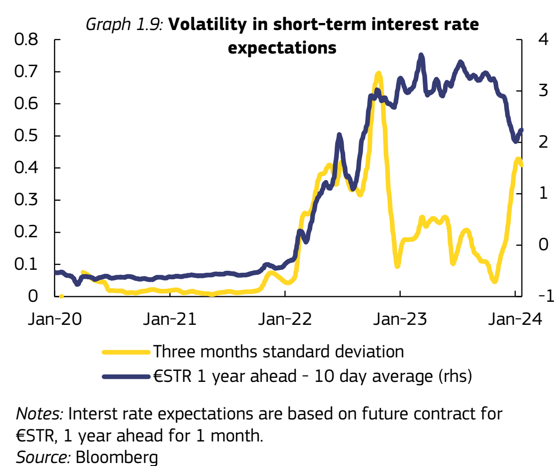
Bolstered by rapidly falling inflation, financial markets expect the ECB to start cutting rates sooner and more forcefully than anticipated last autumn. Since the cut-off date of the Autumn Forecast, markets have ramped up bets on earlier cuts in interest rates. Markets now expect a first rate cut already in 2024-Q2 and cumulative cuts of close to 200 bps. over the forecast horizon (compared to around 100 bps. at the time of the Autumn Forecast) (see Graph 1.8). It should be noted that over the past two years, volatility in market expectations about future policy rates has been sizeable, especially at times of turning points (see Graph 1.9). Moreover, markets systematically underestimated the successive increases in policy rates communicated and decided by the ECB.

Graph 1.8: **Short-term euro interest rate expectations at different dates**



Note: Expectations based on future contracts for 3 months Euribor.
Source: IHS Markit, Refinitiv, Bloomberg, ECB

Graph 1.9: **Volatility in short-term interest rate expectations**

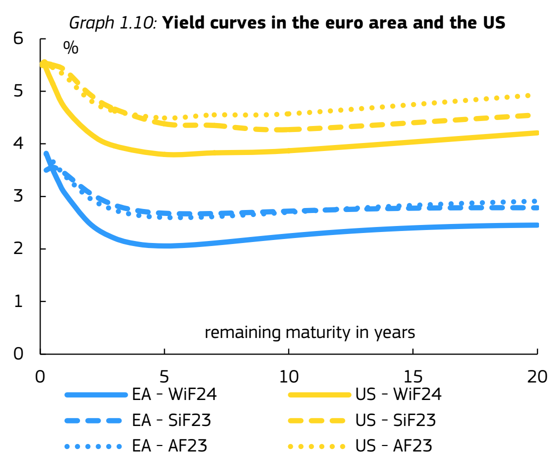


Notes: Interst rate expectations are based on future contract for €STR, 1 year ahead for 1 month.
Source: Bloomberg

([1]) The ECB has continued to reinvest the principal payments from maturing securities purchased under the Pandemic Emergency Purchase Programme (PEPP), but it announced that it would start reducing the PEPP portfolio by EUR 7.5 bn per month on average in 2024-H2 and stop reinvestments at the end of 2024.

Sovereign bond yields declined across the board, while spreads narrowed. Despite large-scale sovereign issuances and reduced asset purchases by the Eurosystem, EU sovereign bond markets adjusted towards lower yields across maturities (see Graph 1.10) ([2]). This is also due to a decline in inflation expectations (Graph 1.30 in Section 1.5.2.). The German 10-year bund yield declined from 2.85% at the Autumn Forecast cut-off date to 2.2% on 1 February, after reaching a low of 1.9% at the end of December. Long-term yields for other EU countries fell even more, leading to narrowing spreads across the EU. Italy and Greece experienced the most pronounced decline in spreads since the Autumn Forecast cut-off date, as they benefited from positive rating developments and investors' search for yield.

Graph 1.10: **Yield curves in the euro area and the US**



Sources: ECB, US Department of Treasury.

Risk premia on private sector assets have also declined. Corporate spreads, including in the high yield segment, have narrowed. Meanwhile equity valuations soared with the Eurostoxx600, the European benchmark index, increasing by more than 10% since the Autumn Forecast cut-off date. The twin rally in bonds and equities signals that markets believe that the ECB will succeed in taming inflation without causing a deep contraction of economic activity. Still, in the riskiest European corporate bond segment (CCC and lower ratings), spreads have recently slightly widened, in contrast with the US experience. This suggests that the EU's economic stagnation and weaker growth outlook is still set to weigh on credit risk of weaker corporations.

The euro remained broadly stable in nominal effective terms. This stability since the Autumn Forecast resulted from diverging bilateral developments that were partly due to changes in expected monetary conditions in the different large economies. On the one hand, the euro appreciated slightly against the US dollar, reflecting the adjustment of markets' expectations regarding the relative easing of monetary policies in the US and in the euro area. It also appreciated against the Chinese renminbi, the Japanese yen and the Turkish lira. On the other hand, it depreciated against the British pound, the Swiss franc and against the currencies of other EU Member States (the Swedish krona and the Polish zloty).

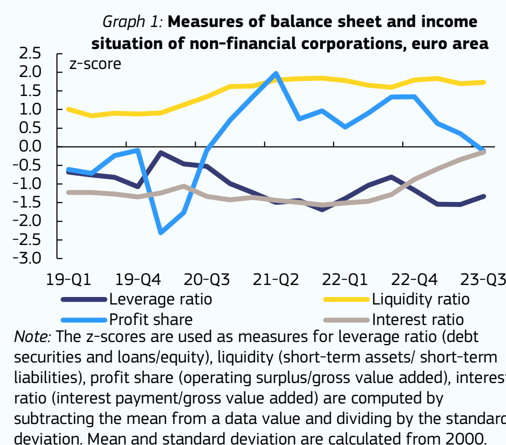
The ECB bank lending survey for the fourth quarter of 2023 still shows forceful transmission of past policy rate increases into lending conditions. Euro area banks continued to report tighter credit conditions to both corporates and households in the last quarter of 2023, but the change was more moderate than in previous quarters. Notably, the tightening in 2023-Q4 was lower than the historical average of quarterly tightening for corporate and house-purchase loans. Banks' risk perceptions continued to contribute most to the tightening of credit conditions. Banks reported further declines in credit demand for the fourth quarter of last year, but the net decrease was more moderate than in the previous quarters. Higher interest rates remained the main cause of lower demand for all types of loans. Lower fixed investment appears as the second reason for low demand from firms, while consumer confidence and housing market prospects are mentioned as drivers for the decline in demand by households. For the first quarter of this year, banks expect a further, but moderate, net tightening of credit standards for both firms and households, while demand is expected to increase mildly. Demand would thereby also surpass the historical average.

([2]) The methodology for long-term interest assumptions has been revised and is now using forward sovereign rates for all countries where data is available. See Box "Some technical elements behind the forecast" in the Statistical Annex.

Box 1.2: **EU non-financial corporations in a challenging economic environment**

Relatively healthy balance sheet positions and strong policy support helped non-financial corporations (NFCs) weather the pandemic and energy shocks. Still high input costs, tight monetary conditions and slowing demand are now testing the resilience of the corporate sector. Latest available data indicate a marginal, though managable, deterioration in banks' aggregate asset quality. However, real time information from financial markets points to decreasing credit risk in some corporate segments. Still, at the lowest end of the credit quality spectrum concerns about defaults remain.

Graph 1: **Measures of balance sheet and income situation of non-financial corporations, euro area**



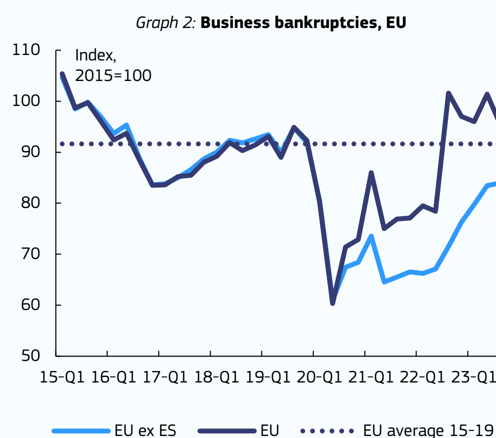
Note: The z-scores are used as measures for leverage ratio (debt securities and loans/equity), liquidity (short-term assets/ short-term liabilities), profit share (operating surplus/gross value added), interest ratio (interest payment/gross value added) are computed by subtracting the mean from a data value and dividing by the standard deviation. Mean and standard deviation are calculated from 2000.

Resilient corporate balance sheets have been a key element of the post-pandemic recovery. EU non-financial corporations entered the pandemic crisis in a solid position. According to sector accounts, debt-to-equity ratios were at historically low levels. Liquidity ratios were also relatively high, against the background of supportive financial conditions. The exceptional policy response during the pandemic was crucial in preserving healthy corporate balance sheets, allowing them to retain their equity and liquidity positions without accumulating high debt levels. ([1]) In 2023-Q3, leverage and liquidity ratios remained roughly at pre-pandemic levels, while the ratio of debt to gross operating surplus started decreasing in 2021.

Skyrocketing energy prices, rising labour costs and surging interest rates have, however, weighed on firms' profitability. The post-pandemic rebound lifted profitability, further improving firms' positions. The phasing out of pandemic-related support measures, surging energy prices, rising interest rates and increasing labour costs have, however, taken a toll on corporate earnings. The profit share has been declining since the beginning of 2023, and the ratio of gross operating surplus to interest spending, a proxy for corporates' debt service capacity, has dropped since mid-2022 (see Graph 1).

Business bankruptcies in the EU have registered a broad-based increase in recent quarters. The policy response to the pandemic crisis also included temporary changes to insolvency procedures and bankruptcy moratoria. These, in addition to the judicial backlog accumulated during the lockdowns, kept bankruptcies low until the third quarter of 2022, when their number surged briskly. Thereafter, this number has fluctuated above its pre-pandemic long-term average, with the latest available quarterly reading for 2023-Q3 showing a slight moderation. These developments, however, are heavily distorted by individual countries, especially Spain that has an important weight in the EU aggregate and underwent an important revision in the legal insolvency framework implemented in September 2022. ([2]) This legislative change resulted in

Graph 2: **Business bankruptcies, EU**



([1]) See IMF (2021), Departmental Paper No 2021/015, [Who Bore the Brunt of the Pandemic in Europe? Shifting Private Stress to the Public Sector (imf.org)]

([2]) Two additional factors might bias bankruptcies data in Spain: the large share of natural persons amongst insolvency procedures and a change in the statistical institution preparing Spanish statistics as of 2021.

(Continued on the next page)

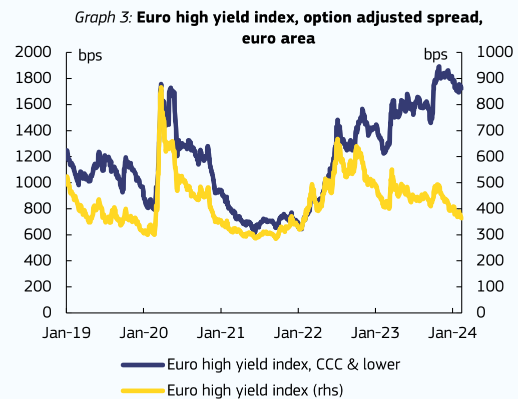
Box (continued)

a sharp increase in bankruptcy declarations in 2022-Q3, which reverted towards long-term trends in following quarters. Excluding Spain, the number of bankruptcies across the EU moved up less abruptly, but has kept creeping up towards the pre-pandemic average (see Graph 2). In 2023-Q3, the number of bankruptcies (compared to the same quarter of the previous year) increased further. In Germany and France it exceeded pre-pandemic levels. ([3]) While these developments deserve careful monitoring, they represent a rebalancing after several years of policy-induced subdued bankruptcy activity.

Survey results suggest that vulnerabilities in the corporate sector are increasing. The ECB's bi-annual Survey on the Access to Finance of Enterprises (SAFE) in the euro area, allows to identify financially vulnerable firms. These are defined as firms facing (i) lower turnover, (ii) decreasing profits, (iii) higher interest expenses, and (iv) a higher or unchanged debt-to-assets ratio. The share of financially vulnerable enterprises surged in the acute phase of the pandemic, but came down during the post-pandemic rebound. In the latest survey (covering the period from April to September 2023), the share jumped to 9% (compared with 6% in the previous round), close to the levels seen during the outbreak of the COVID-19 pandemic. ([4]) This important increase in financial vulnerability heralds a likely increase in the number of bankruptcies in the near-to-medium term.

Growing vulnerabilities and rising bankruptcies have so far resulted in only a marginal deterioration of banks' asset quality. So far, banks reported only a marginal deterioration in credit quality. In 2023-Q3, the share of loans that deteriorated significantly in quality since initial recognition but still does not offer objective evidence of a credit loss event – i.e. stage 2 loans – is below the peak of 2022-Q3, but still relatively high. The euro area banking sector, moreover, appears able to absorb a potential deterioration of asset quality. The volume of non-performing loans has so far been stable at historically low levels, while on average the banks' capital and liquidity positions remain strong.

Graph 3: **Euro high yield index, option adjusted spread, euro area**



Source: ICE Bank of America Merrill Lynch, DataInsight.

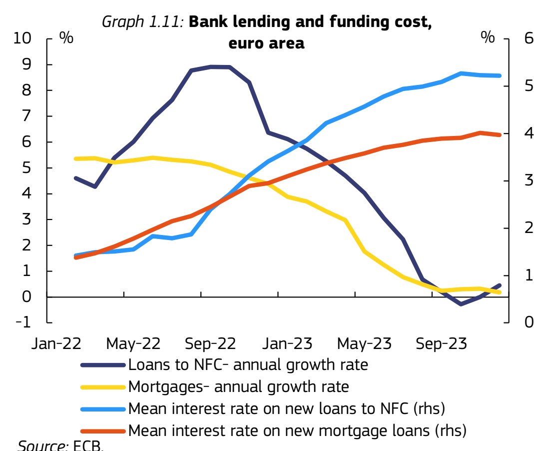
Real time signals from financial markets point to decreasing credit risk. Several metrics of credit risks have been receding in recent months. Aggregate Credit Default Swaps (CDS) indices are a good proxy of financial markets' assessment of credit risk. In late January, the Itraxx Crossover – i.e. the key European benchmark index covering CDSs of European high-yield (speculative grade) corporates – decreased further since its peak in October 2023, standing well below stress levels (established threshold of 600 bps.). Spreads between investment and speculative grade corporate bonds – another metric of credit risk – also narrowed (see Graph 3), after reaching "stressed" levels in the third quarter of 2022. These real-time indicators suggest that default risks are receding, even if the signal is limited to larger corporations with publicly listed equity and/or debt instruments. Credit spreads at the lowest end of the credit quality spectrum (i.e. corporations with CCC rating or lower) have been moving upward. The low-quality credit segment remains relatively small in EU financial markets, but these divergent developments suggest that amidst an overall improved credit outlook, weaker corporations still face significant challenges.

([3]) The increase must be seen against the background of a large increase in the number of new businesses over the same period: since the pandemic, the large gap between stagnating bankruptcies and buoyant business registration resulted in rapid expansion of the number of businesses, especially in Germany.

([4]) See ECB (2023), Survey on the Access to Finance of Enterprises in the euro area - April to September 2023

Bank lending seems to be approaching a turning point. In line with the ECB bank lending survey, bank lending to the private sector in the euro area remained subdued for both households and corporates, with nominal values up by 0.5% year-on-year in December. For corporates, the annual growth rate reached 0.4%, up from 0.2% in September, thanks to strong monthly increases in the last two months of the year. For households, the annual growth rate stood at +0.3%, somewhat lower than in September, when it recorded a 0.8% annual growth (see Graph 1.11). In non-euro area Member States bank lending is also on a downward trend, but the annual growth rates are overall higher in the eastern European countries. The composite cost-of-borrowing indicator for new loans in the euro area remained roughly unchanged in December compared with the previous two months. For corporations it stood at 5.22%, while for house purchases by households it averaged 3.97%. Positively, there is evidence of interest rate declines in some market segments at the start of the year which should also have a positive impact on lending volumes in the following quarters.

Graph 1.11: **Bank lending and funding cost, euro area**



Source: ECB.

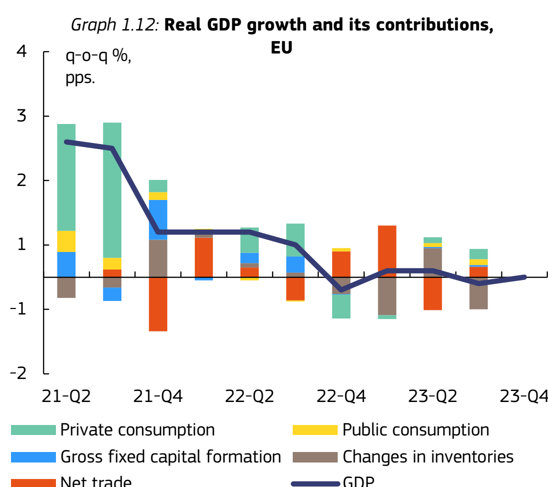
Overall, markets expect the EU economy to achieve a soft landing, but uncertainty of future monetary decisions is elevated, while financial vulnerabilities in the corporate sector are on the rise. Latest developments in financial markets are positive and the interest rate risk has become less prominent. The recent rally in bond and equity markets suggests that investors expect that inflation will converge to target, with economic activity escaping a recession. Still, the high volatility of interest rates suggests that market uncertainty is high and is likely to persist as long as the ECB does not embark on or commit to an explicit path of loosening. Moreover, the macroeconomic environment is starting to weigh on less-solid corporations. Yields in the weakest end of the credit quality spectrum have already moved up somewhat, while bankruptcies rose slightly over the last few quarters (see Box 1.2). Non-performing loans, however, are at very low levels, and banks are well positioned to manage potential downgrades of asset quality.

1.4. RECENT ECONOMIC DEVELOPMENTS IN THE EU

1.4.1. Economic activity

The EU economy continues to perform below expectations. According to Eurostat's preliminary flash estimate for the fourth quarter of 2023, real GDP stagnated in the EU and the euro area, following a mild contraction of 0.1% in both areas in the third quarter. Therefore, the EU and the euro area narrowly escaped a technical recession (defined as two consecutive quarters of negative growth) in the second half of 2023. Economic developments have now been muted for five quarters in a row, with real GDP remaining largely at the same level as in the third quarter of 2022 (see Graph 1.12). Moreover, this is the third quarterly release that comes in below the Commission's forecasts.

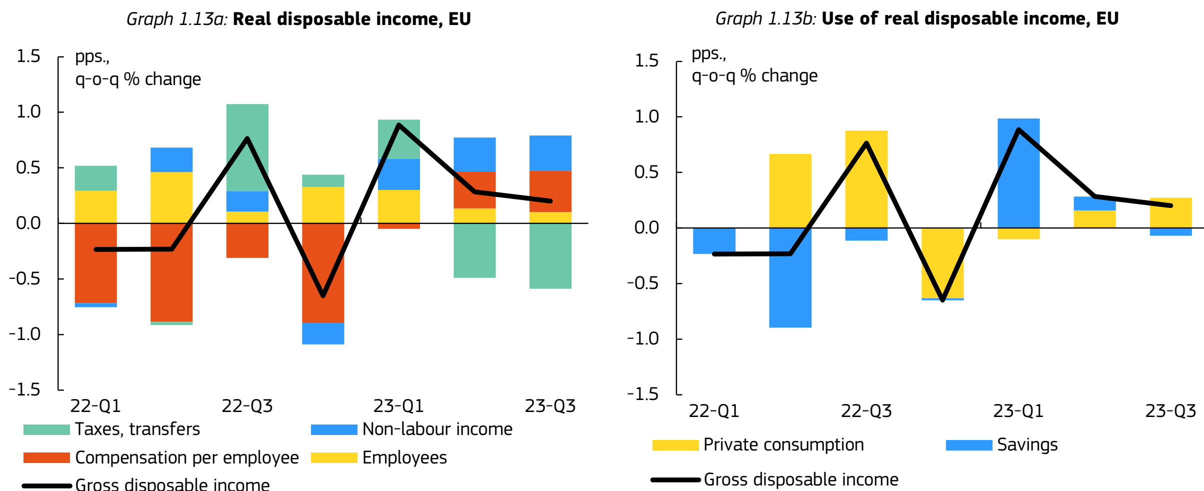
Graph 1.12: **Real GDP growth and its contributions, EU**



After declining in late 2022, household consumption failed to recover in 2023. Subdued consumption has been a key factor for the muted real GDP developments in 2023 (see Graph 1.12). Households' disposable income started improving in 2023-Q1 as employment continued increasing and real wage growth resumed. Non-labour income also boosted household earnings, not least due to some improvement in net real interest income (see Graph 1.13a). By contrast, the decline in net transfers detracted from income growth. Still high savings, however, held back the expected vigorous rebound in consumption (see Graph 1.13b). The saving rate edged up again in the first quarter (to 13.5%) and remained above the pre-pandemic average (12%) in the second (13.4%) and third quarters (13%) (see Graph 1.27), thus also cutting short the expected vigorous rebound in consumption. A similar development was observed for the euro area household saving rate (see Box 1.3).

Graph 1.13a: **Real disposable income, EU**

Graph 1.13b: **Use of real disposable income, EU**



Investment growth for January-September 2023 slowed to 1.1% y-o-y (from 3% for 2022). Growth was driven by investment in transport equipment (3) (1 pp.), as well as in infrastructure, other equipment and intangibles, which contributed a combined 1.2 pps. By contrast, residential investment was a major drag on overall investment growth, which subtracted 1 pp. The positive result for 2023 largely reflected the pick-up in investment up to 2022-Q3, while developments since the end of 2022 and throughout 2023 were muted. Early national accounts data releases for Germany (for 2023), Spain and France (for 2023-Q4) already pointed to weakness of equipment and construction investment.

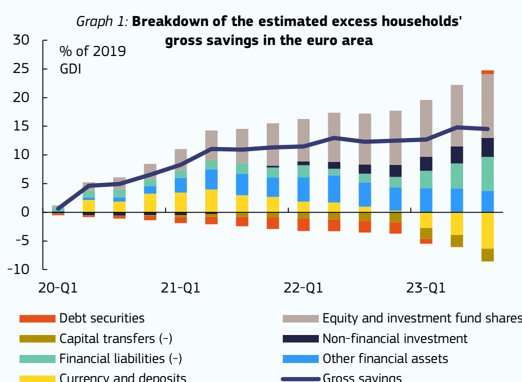
Net trade contributed positively to growth in the first three quarters of 2023, though due to the fall in import volumes outpacing that of exports. While the net trade contribution to growth turned out better than forecast in autumn (neutral rather than negative for the euro area and positive rather than negative for the EU), the declines in the overall volume of foreign trade - both exports and imports - indicate continued weak activity in the tradable sector over the summer. The 2023-Q3 outturn repeats the pattern of preceding quarters whereby weak foreign demand weighed on exports, while weak domestic demand and manufacturing activity caused a decline in imports.

(3) Does not include transport infrastructure like roads, railways etc.

Box 1.3: **Household savings and wealth in the euro area – implications for private consumption**

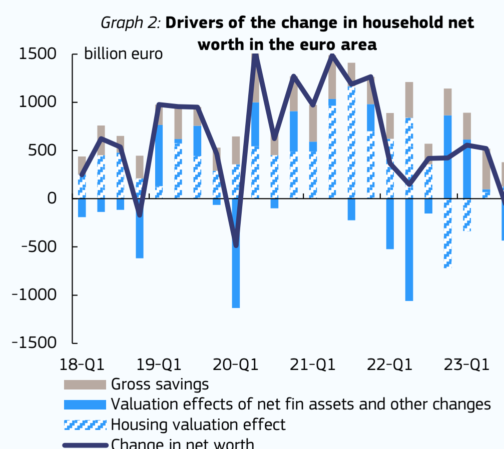
Since the onset of the pandemic, households in the euro area have accumulated a large stock of savings. The household saving rate in the euro area (seasonally adjusted) increased from a quarterly average of around 13% of gross disposable income in 2019 to around 21% between 2020-Q2 and 2021-Q1, driven by restrictions to consumption as well as policy measures that compensated for labour and non-labour income shortfalls ([1]). A precautionary motive likely also played a role, as uncertainty and especially unemployment expectations surged at the onset of the pandemic. Thereafter, the saving rate declined gradually until the second quarter of 2022 - but remained above its pre-pandemic average - as restrictions to mobility were reduced and gross disposable incomes grew steadily, despite the gradual reduction of fiscal support. Taken together, these developments led to an accumulation of excess savings (see Graph 1) – defined as the amount of excess savings compared to a counterfactual situation obtained by using a trend saving rate - estimated at around EUR 1 trillion in 2023-Q3 ([2]).

Graph 1: **Breakdown of the estimated excess households' gross savings in the euro area**



The net worth of households in the euro area saw an even stronger accumulation. The net worth of households includes housing wealth, deposits, pension entitlements, bonds and equity as well as mortgage loan liabilities ([3]). Thus, changes in net worth are due to changes in real estate prices, valuation effects on financial assets and inflows of new savings. Since 2020-Q2, households have accumulated almost EUR 11 trillion of new wealth (80% of 2022 GDP). Until late 2021, above-average increases in house prices and large saving inflows boosted household wealth. Thereafter, the change in net worth slowed down to below pre-pandemic levels, amid negative valuation effects on financial assets in the first half of 2022 and a significant reduction in housing valuations starting in the second half of 2022 (see Graph 2). In 2023, saving inflows ensured continued accumulation of net worth until 2023-Q3, when net worth broadly stagnated. Wealth is highly concentrated among the top 5% of households ([4]).

Graph 2: **Drivers of the change in household net worth in the euro area**



Households did not use their excess savings to boost their consumption as much as expected. Successive European Economic Forecasts had expected that the high level of extra savings, in large part held in liquid assets, would eventually support consumption growth. The expectation was not for a quick release of the excess savings, as much of the foregone spending on services during the lockdown periods could not be recouped and the bulk of excess savings was held by higher income households ([5]), typically featuring a lower propensity to consume. However, the stock of estimated excess savings has remained high and the saving rate has even edged up again to an average of around 14% of gross disposable income in the first three quarters of 2023. The following three

([1]) See Battistini, N., and J. Gareis (2023). "Excess savings: To spend or not to spend," ECB blog, November 2023.
([2]) All excess accumulations are estimated by extrapolation of the 2014 to 2019 trend using ordinary least squares.
([3]) For more details see European Commission (2022). "Box I.2.2 - Household wealth and savings in the euro area – the effect of inflation" In *European Economic Forecast Autumn 2022*, Institutional Paper 187, pp. 32-33. November 2022.
([4]) Based on the European Central Bank's experimental statistics on Distributional Wealth Accounts (DWA) for the euro area.
([5]) See European Central Bank (ECB) (2023). "The consumption impulse from pandemic savings – does the composition matter?" ECB *Economic Bulletin*, Issue 4.

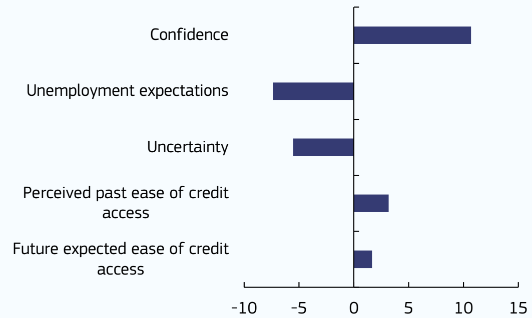
(Continued on the next page)

Box (continued)

factors could potentially explain why the saving rate remains high in the euro area: i) precautionary savings; ii) increased opportunity cost of consumption and reduced benefits thereof; and iii) a need to rebuild financial buffers.

There is little evidence of an increased role of precautionary savings behind the latest uptick in the saving rate ([6])**.** According to the Commission's consumer surveys, consumer confidence, uncertainty and unemployment expectations in the euro area have improved between 2022-Q3 and 2023-Q3 (see Graph 3), though they remain worse than in 2019-Q4. Furthermore, the labour market has continued to perform strongly.

Graph 3: **Changes in consumer confidence surveys for the euro area from 22-Q3 to 23-Q3**

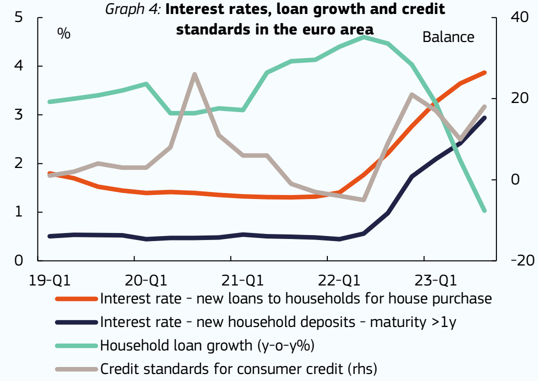


Source: European Commission Business and Consumer survey for Confidence, Unemployment expectatins and Uncertainty, ECB Consumer expectations survey for ease of credit access.

Rising interest rates have increased the opportunity cost of consumption. Since mid-2022, banks have increased interest rates on deposits while tightening credit standards (see Graph 4), thereby raising the opportunity cost of consumption. Accordingly, households re-allocated their savings towards illiquid assets (see Graph 1), including financial assets other than currency and deposits (in particular equity) and real estate. Faced with a higher cost of debt, households also used a growing part of their extra savings to reduce their indebtedness. Also, households that recently used mortgage borrowing to purchase a dwelling may have had to do so with higher downpayments. Despite the recent cooling of housing markets, the financing of real estate purchases has become more difficult ([7]). This is reflected in the ECB's Bank Lending Survey, which shows a strong increase in credit standards for house purchases (see Graph 4), as well as its Consumer Expectations Survey, which points to a worsening of credit access (see Graph 3).

Households might also have increased savings to rebuild financial buffers. High inflation has eroded the real value of wealth, and the increase in the cost of living has offset a significant part of the growth in nominal savings. As a result, the ratio of net worth to private consumption expenditure is almost back to its long-term average of around 800%, after peaking at 970% in 2021-Q1. The ongoing re-allocation of excess savings to financial and real estate assets described above also appears consistent with this motive.

Graph 4: **Interest rates, loan growth and credit standards in the euro area**



Source: ECB.

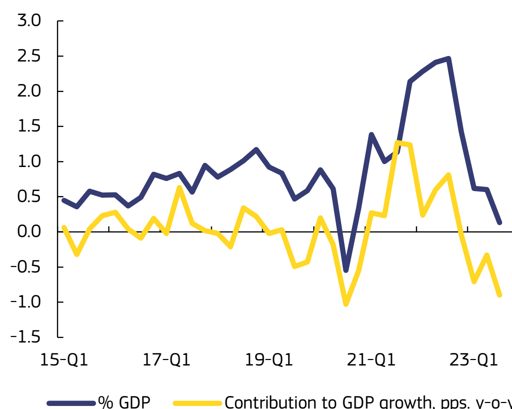
Looking ahead, a significant unleashing of "excess" savings to provide an extra boost to consumption appears less likely than previously thought, also in light of renewed uncertainty. The factors pushing households to hold on to their savings examined above – the increased opportunity cost of consumption and the need to rebuild their financial buffers - are not likely to fade in the near term. The still increasing saving intentions reported by the respondents to the Commission's consumer survey corroborate this expectation. Furthermore, the outbreak of the crisis in the Middle East adds a new element of uncertainty that may prompt precautionary savings. Therefore, a significant boost to consumption from reduced "excess" savings seems unlikely in the near term.

([6]) This analysis focuses on developments in the euro area on aggregate and on a subset of factors influencing the savings behaviour that exhibited the most changes in the concerned period. For individual countries the conclusions might be slightly different, with the precautionary savings motive potentially playing a stronger role. For a comprehensive overview of saving rate developments and determinants across countries, see e.g. Rocher, S. and M.H. Stierle (2015). "Household saving rates in the EU: Why do they differ so much?" European Economy, Discussion Paper 005, September 2015.

([7]) See European Commission (2023). "A cooling housing market amid mortgage rate increases" In European *Economic Forecast, Autumn 2023*, Institutional Paper 258, Special Issue 4.1, pp. 55-59. November 2023.

The drawdown of inventories detracted from growth. The contribution of the change in inventories to growth has fluctuated strongly throughout 2023, but in year-on-year terms it detracted from growth throughout the first three quarters of 2023. This large change in inventories partly hides statistical discrepancies. These were generally sizeable in the post-pandemic years but have been mostly reduced in successive data releases. Still, the gap between the demand and production side of GDP accounting may effectively reflect a continuing drawdown of inventories and a normalisation of the rate of their accumulation, e.g., as energy and other supply disruptions have been resolved (see Graph 1.14).

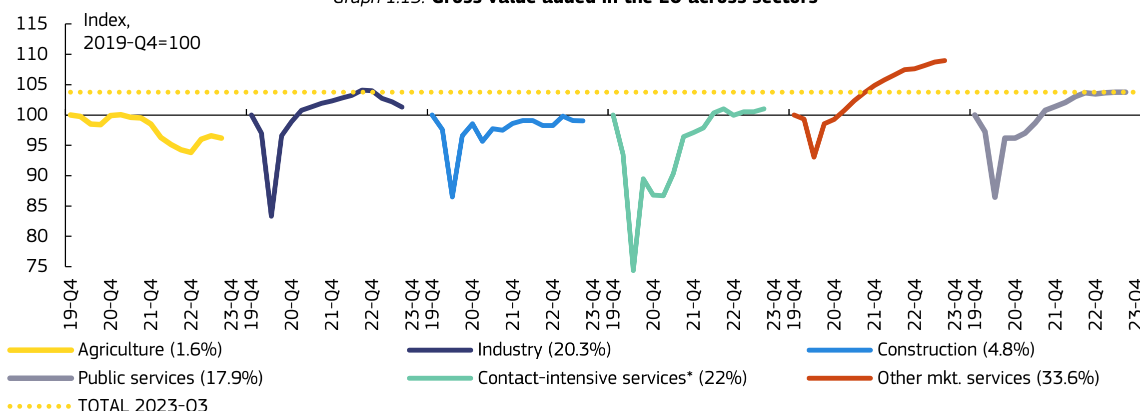
Graph 1.14: **Change in inventories, EU**



Industry and construction deepened their downturn, while contact-intensive services stagnated. Value added in industry has continued declining since the second half of 2022, in line with industrial production. As production in the energy-intensive sectors stabilised at a low level, the decline over most of 2023 took place in the less energy-intensive sectors, notably investment goods (see Graph 1.16). The countries accounting for the bulk of the decline are Ireland (a statistical payback for the strong dynamics in 2022) and Germany, due to a combination of structural (high energy costs impairing international competitiveness, the transformation of the automotive cluster) and cyclical factors (weak demand for investment goods). Construction activity continued to stagnate in view of higher material and financing costs weighing on demand. Value added in the contact-intensive (consumer-related) services recovered to just above pre-pandemic levels, but further growth has been sluggish, possibly reflecting households' restrained spending on non-essential services. In contrast, other market services (e.g., communications, finance and business services) continued growing consistently (see Graph 1.15). Developments in agriculture and public services remained muted over most of 2023, with gross value added in agriculture stabilising at a level still below pre-pandemic values, reflecting also the various extreme weather events affecting Europe last year.

Stagnation of growth in 2023-Q4 was largely driven by a contraction in Germany. For 2023-Q4, continued economic growth was reported in four (Italy: 0.2%, Spain: 0.6%, Belgium and Latvia: 0.4%,) of the 12 Member States for which Eurostat published preliminary flash estimates. In four other Member States, growth rebounded following previous declines (Czechia, Portugal) or moved out of recession (Sweden, Austria). Activity stagnated in France and contracted in Germany (-0.3%), Latvia and Ireland, the latter staying in recession. Growth estimates for the reporting countries ranged from -0.7% quarter-on-quarter (Ireland) to +0.8% (Portugal).

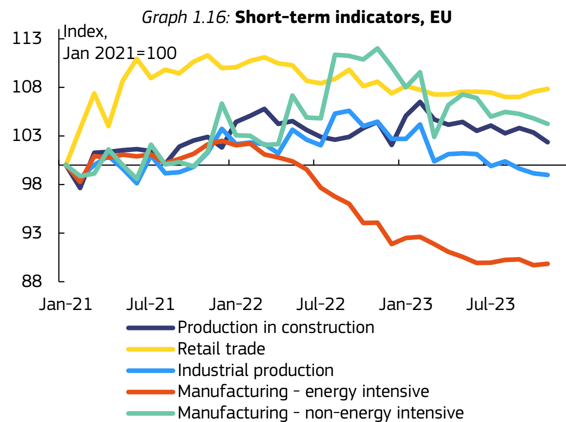
Graph 1.15: **Gross value added in the EU across sectors**



Note: *Wholesale and retail, transport, accommodation, food services; arts, entertrainment, recreation. % of GVA in latest four quarters in brackets.

Latest high frequency data point to continued weakness in industry, construction and retail in late 2023. Data for production in industry and construction in October and November 2023 confirm the declining trend of the first three quarters of the year (see Graph 1.16). Data on retail trade and overnight stays in tourist accommodations do not suggest a major upswing in consumption spending in 2023-Q4.

Graph 1.16: **Short-term indicators, EU**



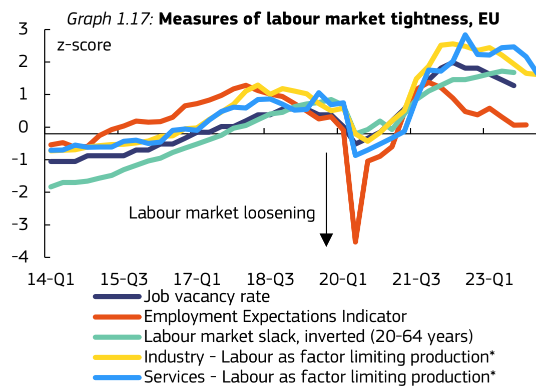
Note: Energy intensive sectors defined as having energy intensity above the average in manufacturing (NACE 16, 17, 19, 20, 22-24).

1.4.2. Labour market

The EU labour market remained strong in the third quarter of 2023. Recent data suggest that the labour market remained resilient in the face of stagnating economic activity. According to national accounts, employment in the EU and the euro area continued to expand in 2023-Q3 (by 0.2% q-o-q, up from 0.1% in Q2). In the same period, based on the Labour Force Survey, the EU employment rate of people aged 20-64 stood at 75.3% (74.8% in the euro area), close to the record high reached in the previous quarter. The unemployment rate was stable in December, standing at 5.9% in the EU and 6.4% in the euro area, back to the record lows achieved in May and June. The broader measure of labour market slack, which includes other groups with an unmet need for employment (i.e. part-time workers who want to work more, people who are available to work but do not look for work, and people who are looking for work but are not immediately available), stood at 11.3% of the extended labour force aged 20-64, a notch higher than the record low reached in Q2.

Continued employment expansion was accompanied by stagnating hours worked and some signs of labour hoarding by EU firms. Despite the employment expansion, the total number of hours worked stagnated in the last two quarters of 2023, leading to a decrease in hours worked per employee in the EU. The reluctance of firms to reduce employment could be explained by the difficulties experienced by firms in hiring workers, especially for specific skills and as a relatively large cohort is retiring, the need to train workers and the expectation that demand will rebound in the future. The Commission's new survey-based labour hoarding indicator ([4]) - which measures the percentage of managers expecting their firm's output to decrease, but employment to remain stable or increase - supports this view: following the peak reached during the COVID-19 crisis, the percentage of EU firms hoarding labour remains above pre-COVID levels, though in January 2024 it was slightly lower than a year earlier. Among the largest EU economies, labour hoarding in Germany, France and the Netherlands is still higher than a year ago.

Graph 1.17: **Measures of labour market tightness, EU**



Note: Z-scores are used as measures and computed by subtracting the mean from a data value and then dividing by the standard deviation. Mean and standard deviation are calculated from 2000, except for the job vacancy rate and labour market slack. *Share of managers indicating shortage of labour force as factor limiting production.

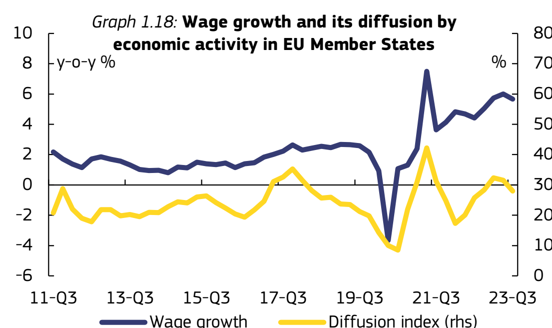
The gap between labour demand and supply is narrowing (see Graph 1.17). Firms are advertising slightly fewer vacancies: in the EU, the job vacancy rate edged down to 2.6% in 2023-Q3 (from 2.7% in the previous quarter). This is still historically high, although down from levels seen at the end of 2021. In January 2024, the prominence of labour as a factor limiting production as reported by business managers in the

([4]) For further details, please see European Commission (2023). *European Business Cycle Indicators, 2nd quarter 2023: A new survey-based labour hoarding indicator*. European Economy Technical Paper 066, July.

Commission's surveys was lower than the high of 2022-Q2 in industry and 2023-Q3 in services, albeit still well above its long-term average. The decline seems to have come to a halt in industry, but not in services. Survey data up to January also confirm that the outlook for employment is dimming, while also remaining marginally above its long-term trend. All in all, the labour market appears still tight by historical standards, but less than it was from late 2021 to early 2023. So far, there is little evidence that the labour market has reached a turning point whereby falling demand would translate into a material contraction of employment and an increase in the unemployment rate. The labour market looks therefore set to withstand the current weakness in economic activity. Employment growth is however expected to be subdued in the upcoming upswing, given evidence of labour hoarding.

Wage growth remained robust but started decelerating. Based on quarterly national accounts data, growth of nominal compensation per employee continued to be strong in 2023-Q3 (5.7% and 5.2% from the same quarter in the previous year, in the EU and euro area respectively), mainly due to a strong increase in industry. However, this was a slight slowdown compared to the previous quarter for both aggregates, with the deceleration being broad-based among sectors across EU Member States. Graph 1.18 shows a diffusion index ([5]) capturing the breadth of the deceleration of wage growth in the economic activities of the EU (based on data for wages and employment by Member State and NACE classification of economic activities). Wages were accelerating for two consecutive quarters for around 20% of the EU workforce. This percentage is well below the share in 2023-Q1 (40%), and the peak reached in 2020-Q4. Wage growth is expected to persist over the coming quarters, in response to workers' demand to recoup lost purchasing power in the previous years. This expectation is corroborated by the increase in wages agreed for incumbent workers. The annual growth rate of negotiated wages in the euro area accelerated in the third quarter of 2023 to 4.7% y-o-y (up from 4.4% in the previous quarter), the highest reading in the series. However, the indicator of nominal wage growth in job postings (i.e. for newly hired workers) showed a deceleration in 2023-Q4 in the euro area. This is valid for a number of euro area Member States, such as Germany, France and Spain, while the opposite happened in the Netherlands.

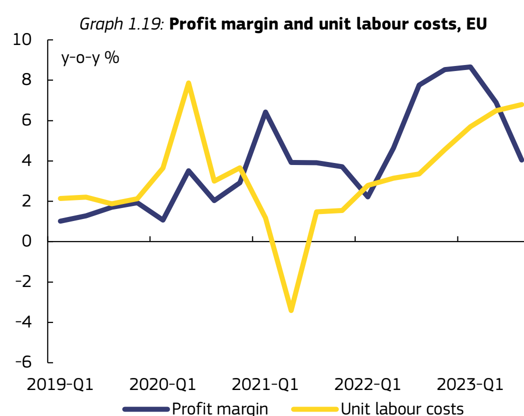
Graph 1.18: **Wage growth and its diffusion by economic activity in EU Member States**



Note: Wage growth is the y-o-y nominal compensation per employee of the EU for the total economy. The diffusion index is expressed as a percentage of the economic activities (NACE Rev. 2) in the EU Member States' economies showing an acceleration in the wage growth for two quarters in a row. It is weighted by the compensation of employee by activity and by country. The index is expressed as a 3-terms moving average.

Going forward, wage growth is expected to allow past losses in workers' real incomes to be recouped without fuelling inflation. Falling growth in profit margins (see Graph 1.19) suggests that firms were absorbing increased labour costs rather than passing them on to consumers with higher prices. Also, as economic growth gains pace, labour productivity is set to grow and to accommodate a higher wage growth than inflation in 2024 and 2025. Further, labour productivity gains, as well as a decline in corporate profit margins, are set to allow inflation to return back towards the target.

Graph 1.19: **Profit margin and unit labour costs, EU**



Note: Profit margin is the annual change of the ratio of gross operating surplus to real GVA and unit labour cost is the annual change of the ratio of compensation of employees to real GVA.

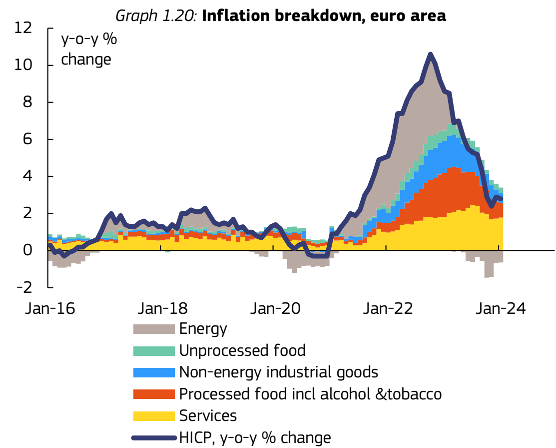
([5]) The diffusion index measures the percentage of sectors in the economic activities across the 27 EU Member States showing an acceleration in the y-o-y growth rate of nominal compensation per employee, weighted for the compensation of employee by sector and by country, for two quarters in a row. It is expressed as a 3-terms moving average.

1.4.3. Inflation

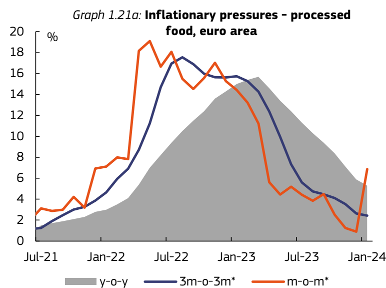
In the fourth quarter of 2023, lower energy commodity prices and weaker economic momentum eased price pressures more than expected. Headline inflation in the fourth quarter averaged 2.9% y-o-y in the euro area, some 0.7 pps. below the Autumn Forecast projection. Energy accounted for most of the downside surprise as sharply lower energy commodity prices pushed consumer energy deflation deeper than forecast in October. Moreover, weaker-than-expected economic momentum eased price pressures in services and non-energy industrial goods. On the contrary, inflation of unprocessed food posted robust monthly price gains, surprising on the upside in the fourth quarter.

Looking through short-term volatility, price pressures continued to moderate in recent months. HICP inflation in the euro area fell sharply in October, to 2.9%, and further down to 2.4% in November (the lowest since mid-2021). It rebounded to 2.9% in December and edged back down to 2.8% ([6]) in January (see Graph 1.20). This pattern reflected the interplay between weakening inflationary pressures and volatile base effects, largely linked to the previous year's developments in energy prices. Base effects evolved from strongly negative in October, through neutral in November to strongly positive in December, when they were solely responsible for the uptick in the headline annual rate. They turned mildly negative again in January.

Graph 1.20: **Inflation breakdown, euro area**

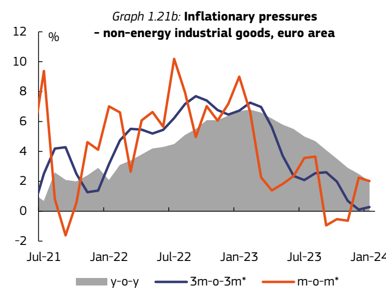


Graph 1.21a: **Inflationary pressures - processed food, euro area**



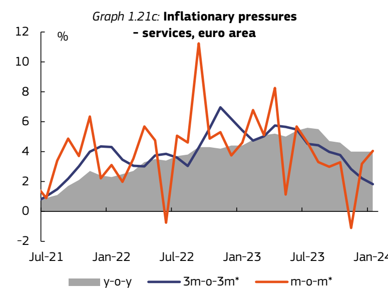
Note: * seasonally and working-day adjusted, annualised

Graph 1.21b: **Inflationary pressures - non-energy industrial goods, euro area**



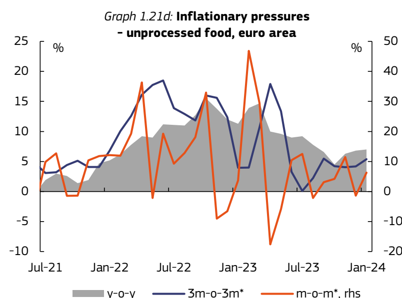
Note: * seasonally and working-day adjusted, annualised

Graph 1.21c: **Inflationary pressures - services, euro area**



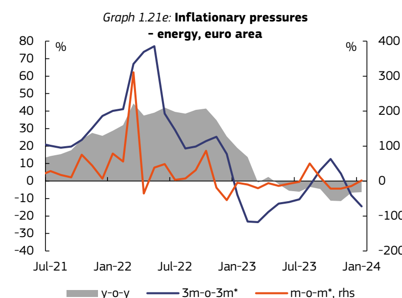
Note: * seasonally and working-day adjusted, annualised

Graph 1.21d: **Inflationary pressures - unprocessed food, euro area**



Note: * seasonally and working-day adjusted, annualised

Graph 1.21e: **Inflationary pressures - energy, euro area**



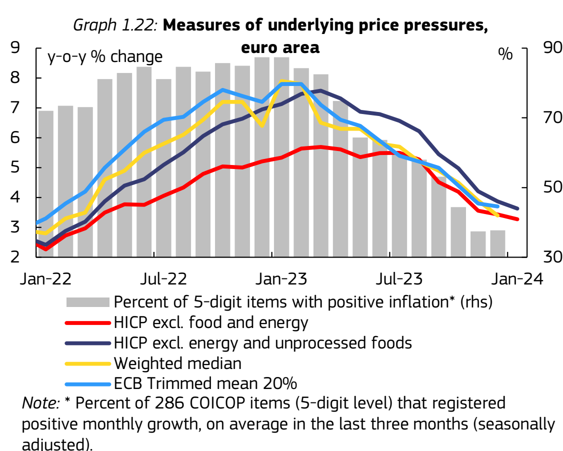
Note: * seasonally and working-day adjusted, annualised

In the last four months, inflation fell sharply in processed food and industrial goods but increased in unprocessed foods and energy. Annual deflation of consumer energy prices narrowed from -11.2% in October to -6.3% in January, as positive base effects and expiring energy measures outweighed the effect of lower energy commodity prices. Still, cheaper crude oil and natural gas pushed down consumer prices of fuel

([6]) Eurostat flash estimate.

for transport, gas and electricity in the fourth quarter. January 2024 saw an uptick in energy prices, likely reflecting rising Brent oil prices as well as the impulse from expiring gas and electricity policy measures. For all other HICP components, annual inflation moderated further in the four months to January, with the exception of unprocessed food (see Graphs 1.21a to e). The latter picked up visibly in November and continued to increase in December and January (to 7% y-o-y, up by 2.5 pps. from October), as robust monthly price gains of fresh vegetables and, to a lesser extent, fruit were magnified by positive base effects. Inflation of processed food, however, continued on a downward trend, falling by nearly 4 pps. in the last 4 months, to 5.3% y-o-y in January, amid a gradually moderating price momentum ([7]). Likewise, non-energy industrial goods saw annual inflation moderate further, to 2% y-o-y in January (1.5 pps. down from October), as the price momentum fell to nearly zero in December and January. Annual inflation of services dropped sharply from 4.6% in October to 4.0% in November to remain unchanged at this level through January. While disinflation has stalled on a year-on-year basis since December, monthly price pressures in services remained weak throughout the fourth quarter, with price momentum easing to levels last seen in mid-2021.

Graph 1.22: **Measures of underlying price pressures, euro area**

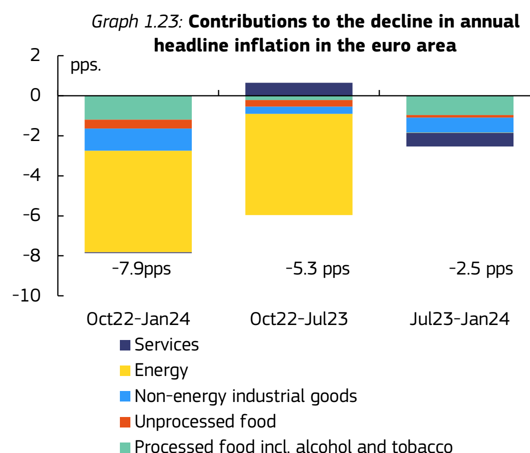


Note: * Percent of 286 COICOP items (5-digit level) that registered positive monthly growth, on average in the last three months (seasonally adjusted).

Underlying inflationary pressures continued to weaken. Despite volatility in inflation of major components, underlying price pressures remained firmly on a disinflationary path. Permanent-exclusion-based measures of underlying price pressures, as well as a range of alternative statistical indicators (trimmed means, weighted medians), continued to decelerate, reaching their lowest levels in roughly two years (see Graph 1.22). Moreover, the 3m-o-3m price momentum, better reflecting *recent* price pressures, confirms their continued moderation since autumn. Finally, the share of HICP items, seasonally adjusted, showing positive month-on-month change on average in the last three months declined further in the fourth quarter, to a 2.5-year low. This suggests that, in addition to weakening, inflationary pressures continue to narrow.

Non-energy goods and services have taken over from energy as the key disinflation factors since the summer of 2023. Annual headline inflation fell by almost 8 pps. between October 2022 (when it peaked at 10.6%) and January 2024, with energy accounting for more than 5 pps., or two-thirds, of this decline (see Graph 1.23). Processed foods and non-energy industrial goods each subtracted a little over 1 pp., while unprocessed food detracted another 0.5 pps. Given the delayed peak of services inflation, its contribution to overall disinflation in this period was negligible. The disinflation pattern has changed significantly since July 2023, which marked the peak of services inflation and near-trough of energy inflation. The 2.5 pps. decline in headline inflation between July 2023 and January 2024 was driven by components with higher demand elasticity, and thus more sensitive to the impact of monetary tightening, i.e. non-energy industrial goods, processed foods and services. Energy has lost its disinflationary impetus since the summer, as its contributions to headline inflation, while still strongly negative, have not changed between July 2023 and January 2024.

Graph 1.23: **Contributions to the decline in annual headline inflation in the euro area**



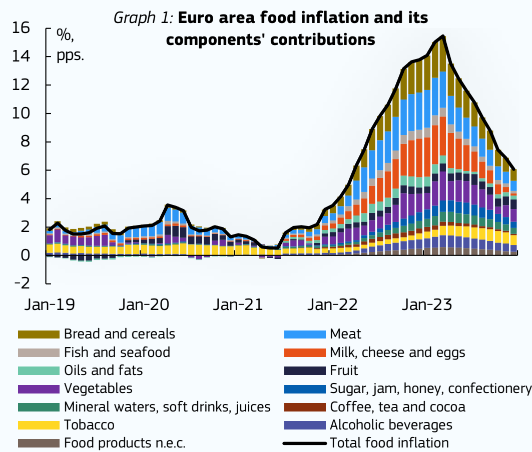
Note: Contributions calculated as changes in the contrbution to euro area annual headline inflation between the two given months.

([7]) The momentum of prices refers to 3m-o-3m percentage growth in seasonally adjusted prices, annualised.

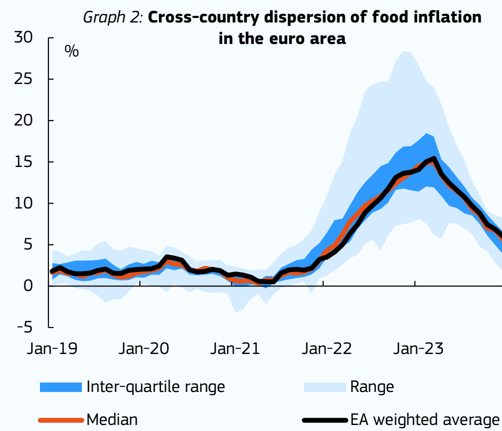
Box 1.4: **Food inflation in the euro area – what were the driving forces behind the extraordinary surge in 2022-2023?**

Food inflation accelerated to unprecedented levels in the euro area in 2022-23, peaking at 15.5% in March 2023. Following energy, the contribution of food inflation to headline inflation was the second highest in this period, reaching 3.1 pps. in February-March 2023. This has raised concerns as food is an important item of households' consumption baskets, most notably for low-income households. Since March 2023, food inflation has been falling rapidly, though it is still high on year-on-year terms (6.1% in December 2023).

The surge in food inflation was broad-based across food items, both processed and unprocessed. In terms of year-on-year inflation rates, only tobacco, alcoholic beverages and fruits stayed below headline inflation during the spike. However, it must be noted that tobacco and alcohol are subject to high levels of excise taxation which dampens the effect of changes in input prices ([1]). Bread and cereals, meat, milk, cheese and eggs, and vegetables are the items that contributed most to the recent spike in food inflation (Graph 1). This is partly due to their relatively high shares in the overall consumption basket.



Graph 1: **Euro area food inflation and its components' contributions**



Graph 2: **Cross-country dispersion of food inflation in the euro area**

Various factors have driven the increase in food inflation, including global commodity price movements due to supply bottlenecks and the energy price shock, but also weather conditions. Input prices, such as those of energy and food commodities and of fertilisers, have been on the rise since early 2021. Climate change and extreme weather events, in particular droughts and floods, have also affected agricultural production, contributing to the surge in food commodity prices. While commodity prices have shown a sizeable correction recently, they are still at elevated levels. Moreover, profit and wages in both the food manufacturing and distribution sectors have picked up in the last two years, further driving up consumer prices.

The dispersion of food inflation among euro area countries has reached unprecedented levels, with some countries experiencing a cumulative food price increase of around 32-42% in the past two years (Graph 2). In addition, countries with the highest food price shocks, such as the Baltics, Slovakia and Croatia, also tend to have the highest share of food in the overall consumption basket. This worsens the impact of the price shock on the cost of living of these countries. Several factors could explain why these five countries experienced higher food inflation. These include: i) a higher exposure to the energy price shock; ii) lower absolute price levels due to a lower share of non-commodity costs (such as wages), which imply a higher relative price increase in response to an external commodity shock; iii) a past history of medium-to-high inflation, which could imply a higher sensitivity to external inflation shocks. In addition, the value-added deflator of the distribution sector – which is an

([1]) Alcoholic beverages and tobacco are included in the special aggregate of food, alcohol and tobacco in the Eurostat classification, which is usually referred to as food inflation.

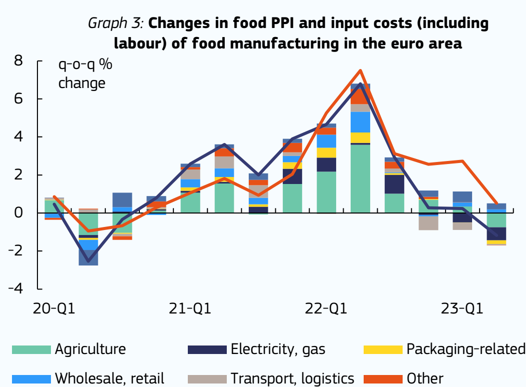
(Continued on the next page)

Box (continued)

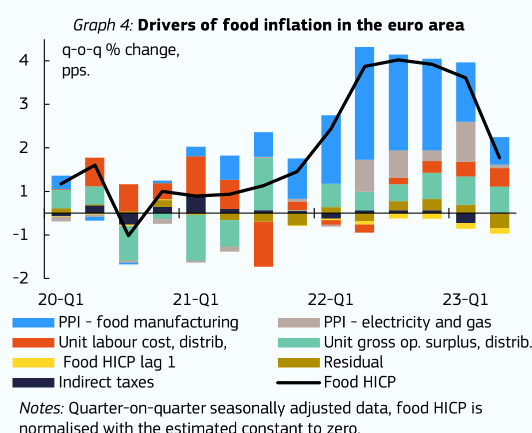
important driver of food consumer prices – increased much more strongly (up to 3.5 times faster) in these countries than the average of the euro area.

The food manufacturing sector saw major input price increases led by agricultural produce, energy, distribution and packaging costs. This can be seen by combining an input-output table analysis with input price indices for the food manufacturing industry, which allows examining the drivers of the input price increases and the extent to which they explain the evolution of the output price of the sector (Graph 3). This shows that the food manufacturing sector saw its input costs increasing faster than its output prices up until the end of 2021, which implied a worsening of profit margins of food producers over that period. Profit margins started to recover as of the beginning of 2022 as input prices fell more sharply than output prices. This indicates that current profits are probably compensating for losses in profitability sustained in the period 2020-2021. As these price pressures eased and some even turned negative in 2023, overall input prices also fell despite a moderate pickup in wages.

Graph 3: **Changes in food PPI and input costs (including labour) of food manufacturing in the euro area**



Graph 4: **Drivers of food inflation in the euro area**



Notes: Quarter-on-quarter seasonally adjusted data, food HICP is normalised with the estimated constant to zero.

Econometric analysis shows that food manufacturing PPI and the value-added deflator of the distribution sector ([2]) (decomposed into unit labour cost and unit gross operating surplus) are the most important drivers of consumer food inflation (measured by the HICP) in the euro area. Electricity and gas PPI also have a small but significant impact, most likely through the energy use of the distribution sector. Agricultural products and food imports do not show significant coefficient estimates, indicating their lower importance in final consumer prices once the other factors – in particular food PPI – are controlled for. A historical decomposition using the estimated coefficients (Graph 4) shows that the main driver of the pick-up in food HICP inflation in 2022 was the food manufacturing PPI. Due to the size of the energy price shock, there was also a substantial impact of electricity and gas inflation on food inflation that year. The unit gross operating surplus of the distribution sector also contributed significantly to food inflation in 2022-23, while unit labour costs started to play an increasing role as of the end of 2022.

As the past shocks were priced in and passed through the entire food value chain, food inflation started falling quickly in 2023. In the absence of renewed pressures on input prices and if wages and profits stay in line with price stability, disinflation should continue, and food inflation should return to historically observed low levels. However, climate change-induced weather volatility, a worsening of the geopolitical situation, potential disruptions in global commodity markets, or excessive growth in wages or profits could pose challenges to food inflation in the future.

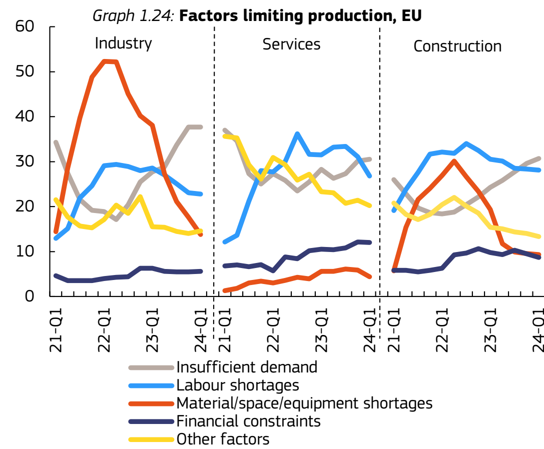
([2]) The distribution sector is approximated with NACE sectors G-I, i.e. wholesale and retail trade, transport, accommodation and food services, for which data is available in the sectoral national accounts. This is wider than food distribution, so caution is necessary when interpreting the results.

1.5. THE OUTLOOK

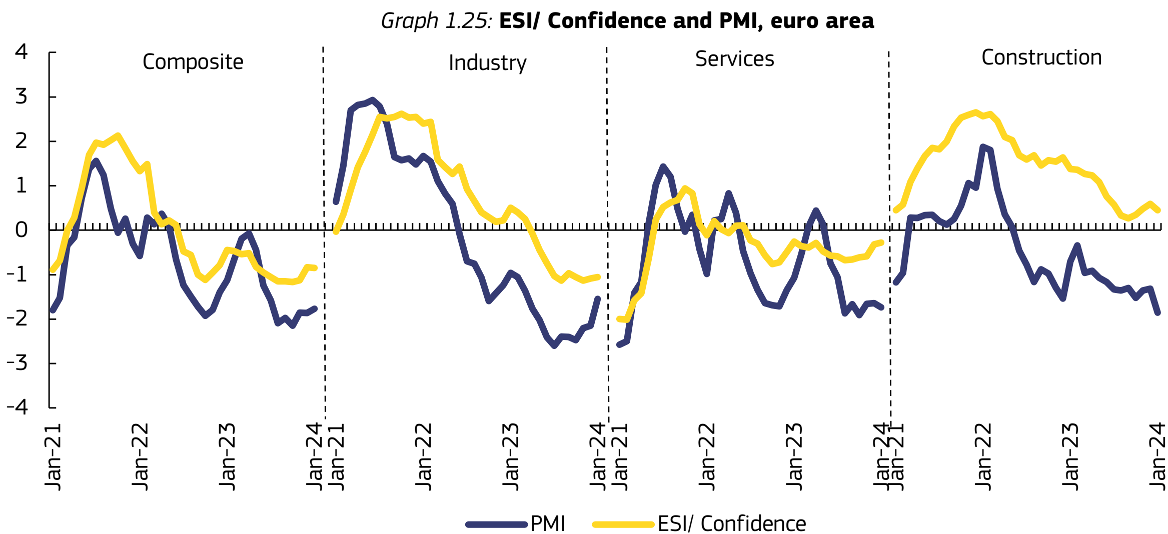
1.5.1. GDP

Survey indicators give tentative signs of bottoming out, though for some the upward trend stalled in January. On a quarterly-average basis, the European Commission's Economic Sentiment Indicator (ESI) largely moved sideways in the EU in the fourth quarter. The trough in confidence seems however behind us and in December the indicator was 2.5 points up compared to September. Disaggregated indicators point to a broad-based improvement of confidence in services, construction and among consumers over the last quarter of 2023, whereas industrial confidence stayed broadly flat throughout the third and fourth quarters. The January results however indicate a pause in the uptick of overall sentiment or even a relapse in some of the component confidence indicators, notably in construction, retail and among consumers. For the euro area, the dynamics of the ESI were broadly in line with the evolution of the HCOB Eurozone Composite PMI Output Index (see Graph 1.25). The ESI remained below its long-term average and the PMI was still shy of the critical 50-points threshold (thus in mildly contractionary territory). Weak demand has confirmed itself as the most prominent factor limiting production, while shortage of material and equipment is far less so than several quarters ago. The severity of labour shortages is gradually easing but is still significant (see Graph 1.24). According to the quarterly manufacturing survey, capacity utilisation continued its broad downward trend observed since spring/summer 2021. On a positive note, the tracker of new orders posted a slight increase, export expectations have stabilised, and the weakening of order inflows has stopped.

Graph 1.24: **Factors limiting production, EU**

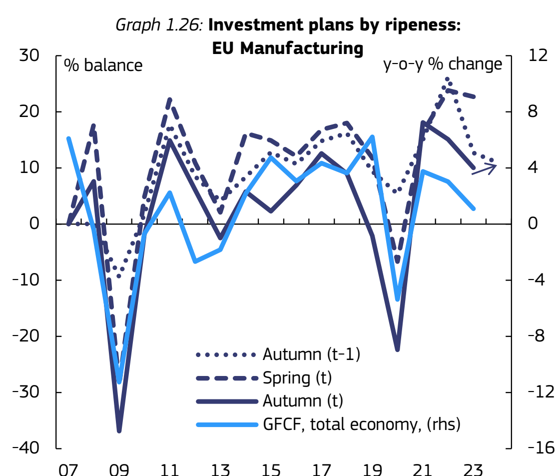


Graph 1.25: **ESI/ Confidence and PMI, euro area**



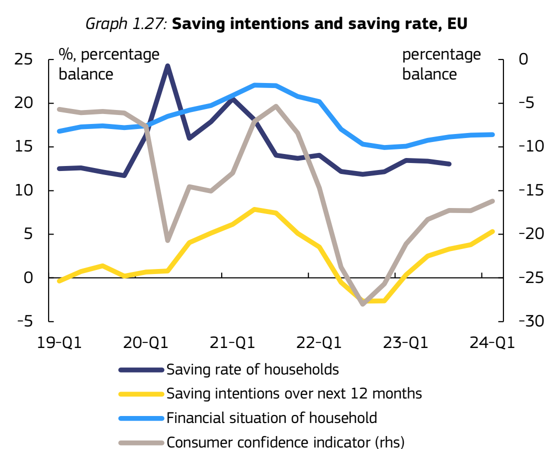
Source: S&P Global, European Commission.
Note: Standardised data based on 2000-'07 sample.

The Commission's October-November business surveys continue to point to a positive outlook for investment in 2024. The net percentage of firms expecting an increase in their firm's investment was significantly lower in 2023 than in 2022, and it is expected to increase only slightly in 2024 (see Graph 1.26). With real GDP in the EU barely growing since late 2022, investment reported in 2023 or planned for 2024 mainly serves replacement purposes. In industry, the share of investment related to extension of production capacity decreased in 2023 and is expected to further drop in 2024. By contrast, the share of investment dedicated to streamlining production processes is planned to increase, suggesting ongoing technological adaptation. Demand and technical factors are reported as the main drivers of investment in 2023 and 2024. Even if still tight, financing conditions seem now set to loosen somewhat more or earlier than assumed in autumn, while corporate balance sheets remain solid on aggregate, despite falling profit margins. Together with the further deployment of NextGenerationEU (NGEU), this is set to benefit investment.



Graph 1.26: **Investment plans by ripeness: EU Manufacturing**

Consumption growth continues to be held back by a high saving rate. The saving rate declined slightly in 2023-Q3 but remains above pre-pandemic average. Recent indications from the Commission's surveys show that an increasing share of consumers intend or expect to be in a position to save over the next 12 months, while assessing their household financial situation to be slowly improving, following the hit from inflation (see Graph 1.27). This may be related to the fact that rising interest rates have increased the opportunity cost of consumption, or that households need to rebuild financial buffers, which have been eroded by inflation (see Box 1.3). Overall, a significant boost to consumption from a declining propensity to save is therefore unlikely.



Graph 1.27: **Saving intentions and saving rate, EU**

The international environment should support growth more than in the past year. The momentum of global economic growth is set to remain broadly intact. Global imports from outside the EU are expected to improve in 2024, as global trade volumes normalise, following sharp post-pandemic swings (see Table 1.1). This should create a supportive environment for export growth.

Annual GDP growth in the EU is projected at 0.9% in 2024 (0.8% in the euro area) and at 1.7% in 2025 (1.6% in the euro area). Overall, the EU economy entered the new year on a weaker footing than previously expected. Prospects for the first quarter of 2024 remain subdued, but the conditions for a progressive acceleration of economic activity this year appear still in place. Real wage growth and resilient employment should support a rebound in consumption, though part of the gains in disposable income will go into savings. Despite falling profit margins, investment is set to benefit from a gradual easing of credit conditions and the further deployment of NGEU, as well as from the need for technological adaptation. Moreover, the EU's external demand is expected to normalise. In the second half of this year, the pace of growth is set to stabilise at cruising speed, broadly in line with potential, until the end of 2025.

All Member States' economies are set to return to growth in 2024. The growth forecast for most major EU economies has been revised down for 2024: Germany (-0.5 pps.), France (-0.3 pps.), Italy (-0.2 pps.), the Netherlands (-0.7 pps.), while remaining unchanged for Poland and Spain and revised up for Sweden (+0.4 pps.) in view of positive surprises in outturn data. Whereas economic activity is expected to have contracted in

11 Member States in 2023, in 2024 all EU economies are projected to expand. Several smaller economies continue to see GDP in 2024 expanding in the 2-3% range.

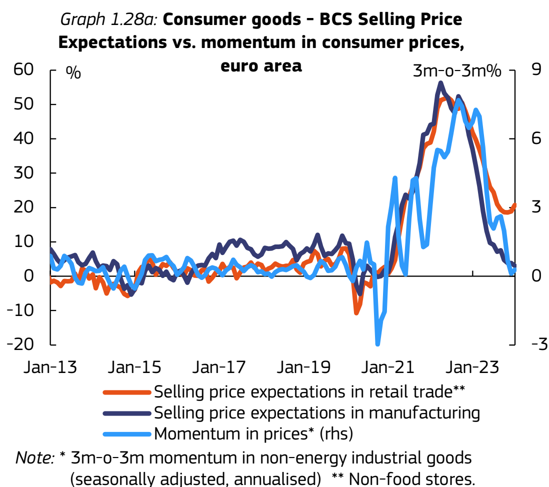
1.5.2. Inflation

Lower energy commodity prices, weaker economic momentum and recent inflation outturns set inflation on a lower disinflationary path than anticipated in the Autumn Forecast. Annual headline inflation is projected to continue moderating over the forecast horizon, even if more month-to-month volatility around trend is to be expected in the near term. With both spot and future prices of energy commodities considerably below the autumn assumptions, consumer energy inflation is set to be lower, notwithstanding upward impulses due to the expiration of policy measures in some Member States. Furthermore, weaker economic momentum and the ensuing lower-than-expected inflation of industrial goods and services in the final months of 2023 imply a lower carry-over to 2024, shifting the 2024 inflation outlook down compared to the Autumn Forecast. Easing pipeline pressures and lower commodity input costs in the food and industrial goods industries should continue underpinning the deceleration in non-energy goods prices (see Box 1.4). Meanwhile, wage pressures, which are developing broadly in line with the autumn projections, are projected to moderate further over the forecast horizon from their peak in mid-2023 (see Graph 1.18). The expected buffering of remaining wage pressures by the decline in firms' profits should provide the necessary conditions for the further progressive moderation in inflationary pressures.

Red Sea trade disruptions, however, are set to slow down the disinflationary process in the near term. The fallout from the widening of the tensions in the Middle East to the Red Sea represents a negative supply shock that has pushed European shipping costs higher and lengthened delivery times. This is expected to affect mainly prices of non-energy goods but may also add to price pressures in food and, to a lesser extent, in services and energy (see Box 1.1).

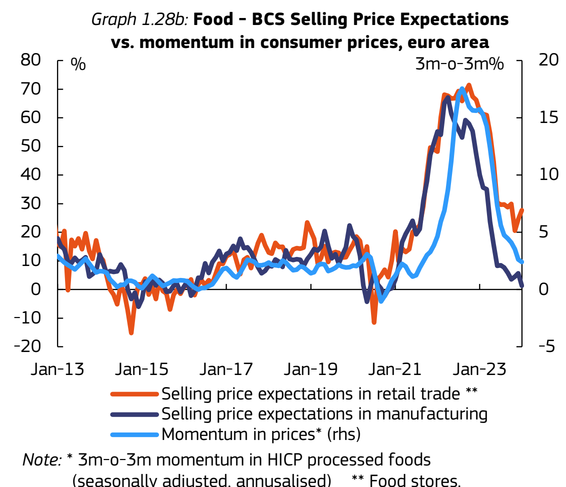
Selling price expectations by business managers corroborate the prospects of continued disinflation in processed food and non-energy industrial goods. BCS selling price expectations (SPE) in manufacturing of food and non-food consumer goods continued to trend down through January, falling to the lowest levels in three years (see Graphs 1.28a and b). In retail, however, selling price expectations picked up slightly for both food and consumer goods' stores in December and January. Given high historical correlations between respective SPEs (both in manufacturing and retail) and the 3m-o-3m momentum of consumer prices, with SPE leading the momentum by some 3-4 months, this could suggest some firming of price pressures in consumer goods and food in the second quarter. However, with the signal weakened by manufacturing SPE pointing firmly to a continuation of the downward trend, the rebound in momentum, even if it materialises, is unlikely to be strong. Given very weak momentum in both HICP components (see Graphs 1.21 and 1.28), this should not translate into a rebound in annual inflation rates, but, rather, may slightly flatten the still downward sloping annual inflation curves for industrial goods and processed food.

Graph 1.28a: **Consumer goods - BCS Selling Price Expectations vs. momentum in consumer prices, euro area**



Note: * 3m-o-3m momentum in non-energy industrial goods (seasonally adjusted, annualised) ** Non-food stores.

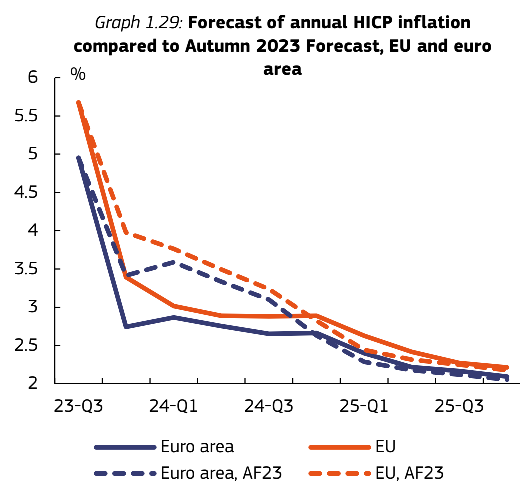
Graph 1.28b: **Food - BCS Selling Price Expectations vs. momentum in consumer prices, euro area**



Note: * 3m-o-3m momentum in HICP processed foods (seasonally adjusted, annusalised) ** Food stores.

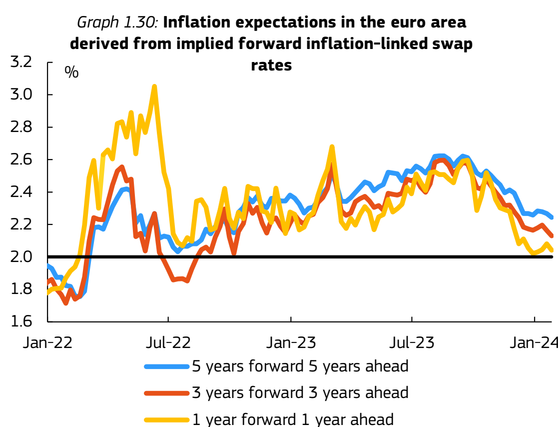
All in all, inflation is set for a faster fall in 2024 compared to the Autumn Forecast, while the outlook for 2025 is broadly unchanged. Starting the year at lower-than-expected levels in both the EU and the euro area, the quarterly inflation profile is set to be flatter in 2024, but to continue trending down over the forecast horizon (see Graph 1.29). The expiry of energy policy measures and the continued presence of non-negligible base effects should increase the volatility of annual inflation around trend in the near term. Following a slight uptick in 2024-Q1, headline inflation is expected to moderate marginally in the second half of the year, before declining more decisively next year, to just above the ECB target in the final quarter of 2025. In the euro area, annual average inflation is set to decline from 5.4% in 2023 to 2.7% in 2024 (0.5 pps. below the Autumn Forecast) and 2.2% in 2025 (unchanged from the autumn). In the EU, headline inflation is projected to ease from 6.3% in 2023 to 3.0% in 2024 (0.5 pps. below the Autumn Forecast) and 2.5% in 2025 (up by 0.1 pps.).

Graph 1.29: **Forecast of annual HICP inflation compared to Autumn 2023 Forecast, EU and euro area**



Inflation expectations of financial markets moved closer to the ECB inflation target. The fast and broad-based disinflation process has also affected financial markets' inflation outlook (see Section 1.3). Downside inflation surprises have pushed euro area inflation expectations at 1, 3 and 5-year horizons down by ⅓-½ pps. since the Autumn Forecast, to 2.0-2.2% in late January, aligning them much more closely to the ECB inflation target (see Graph 1.30). Likewise, the ECB's Survey of Professional Forecasters in 2024-Q1 showed the outlook for headline inflation revised down to 2.4% (2024) and 2% (2025), some 0.3 pps. and 0.1 pps. down respectively, from the prior quarter.

Graph 1.30: **Inflation expectations in the euro area derived from implied forward inflation-linked swap rates**



Source: Bloomberg.

1.6. RISKS TO THE OUTLOOK

Heightened geopolitical tensions tilt the balance of risks to the outlook towards more adverse outcomes. Russia's protracted war of aggression against Ukraine remains an important source of uncertainty for the EU economy. The extension of the conflict in the Middle East to the Red Sea is fuelling additional geopolitical tensions and already adding some upward pressure on prices. Further escalation could renew stress on supply chains, hampering global production and adding to price pressures on tradeable goods. Energy commodities also appear vulnerable. The EU is particularly exposed to these risks, due to its geographical proximity to the ongoing conflicts, its deep integration in global value chains, its energy dependency and the fact that a significant share of its trade takes the Red Sea route (see Box 1.1).

Global policy uncertainty also weighs on the EU economic outlook. China's economy is at a critical juncture. A faster-than-expected retrenchment in economic activity, in the absence of a comprehensive re-orientation of policies, could have negative growth spillovers to the EU economy, but would also further relieve price pressures, especially on energy commodities. The opposite is true in case of a larger-than-expected acceleration of growth in China. In the US, a slower-than-anticipated disinflation process would require policy rates to stay higher for longer, which would strengthen the US dollar and worsen global

financial conditions. Finally, 2024 will be historic in terms of the number of people worldwide voting in elections, with policy uncertainty weighing on investor sentiment.

Domestically, growth and inflation risks appear broadly balanced. On the upside, positive surprises to EU growth could come from faster normalisation of saving behaviour. This would support consumption but could slow the decline in inflation. Higher-than-expected wage growth and a lower-than-anticipated fall in profit margins could also lead to inflation turning out higher than projected. On the downside, a stronger or more persistent transmission of the still tight monetary conditions could further delay the rebound in economic activity, pushing inflation lower. Moreover, financial market exuberance in anticipation of lower policy rates risks offsetting monetary authorities' efforts to bring inflation back to target.

Finally, mounting risks associated to climate change still weigh on the outlook. The materialisation of these risks bears severe costs for the EU economy, in terms of losses in natural capital and key infrastructure, including residential housing and production capital, as well as possible disruptions in economic activity.

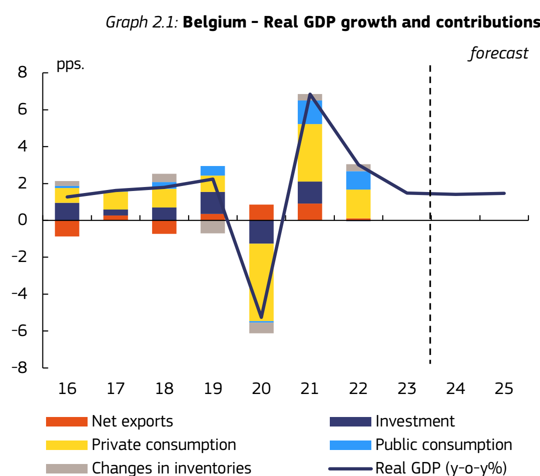
2. PROSPECTS BY MEMBER STATES

EURO AREA

2.1. BELGIUM

The Belgian economy is estimated to have expanded by 1.5% in 2023, slightly more than projected in autumn. Real GDP increased by 0.4% q-o-q in both the third and fourth quarters of the year. Private consumption was resilient in 2023, supported by the automatic indexation of wages and social benefits, which contributed to maintaining household purchasing power. Furthermore, investment recovered strongly, on the back of a rebound in corporate investment.

Graph 2.1: **Belgium - Real GDP growth and contributions**



Going forward, private consumption is expected to expand further, as consumers face lower price increases and employment is still projected to grow. At the same time, the energy transition and the implementation of the Recovery and Resilience Plan (RRP) are set to support gross fixed capital formation. Public investment in infrastructure is also projected to accelerate in the run-up to the 2024 election cycle. By contrast, investment in residential construction is expected to continue to be held back by high financing costs in the short term, before recovering over the forecast horizon amid a moderate easing of financing conditions. After a strong decline in 2023, exports and imports are set to rebound to some extent in 2024 and more vigorously in 2025, in tandem with trading partners' prospects. The contribution of net exports to GDP growth is however forecast to remain negative in 2024 and in 2025, with imports pushed up by private consumption. Overall, GDP growth is forecast to reach 1.4% in 2024 and 1.5% in 2025, unchanged compared to the Autumn 2023 Forecast.

HICP inflation fell to 2.3% in 2023, reflecting the fast transmission of declining wholesale gas and electricity prices to retail prices, along with the effect of government measures to dampen price increases. The withdrawal of these measures is expected to put upward pressure on headline inflation, resulting in a projected increase to 3.5% in 2024. HICP inflation is forecast at 2.3% in 2025 as energy prices are expected to increase at a slower pace. This is lower than in the Autumn Forecast for 2024 and slightly higher for 2025.

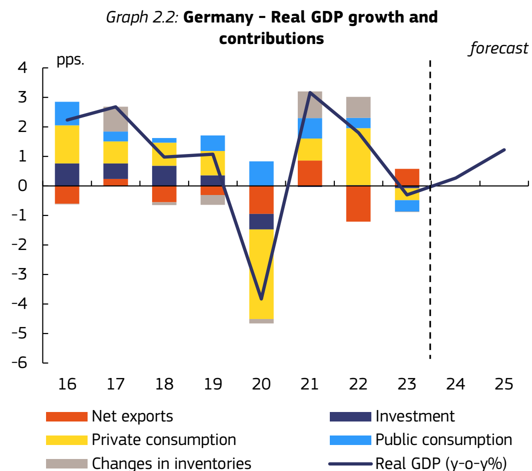
2.2. GERMANY

Economic activity in Germany is estimated to have contracted by 0.3% in 2023, as projected in autumn. Private consumption suffered from a loss in purchasing power. High building and borrowing costs on top of labour shortages and elevated energy prices depressed investment in construction and energy-intensive sectors.

Sentiment indicators continue to be weak, with some indicators in January having reached their lowest levels since the COVID-19 crisis, pointing to subdued economic growth in the first half of 2024. Investment growth is projected to remain low relative to pre-pandemic values, weighed down by downbeat investor sentiment entering the year. Labour shortages continue to be a bottleneck to activity. A trade-led recovery is also unlikely, as exports and imports are set to grow at broadly the same pace in both forecast years. Tighter fiscal policy conditions are also expected to have a dampening impact on short-term growth prospects. On the positive side, market financing conditions have eased moderately and further easing is expected through the bank lending channel. In addition, real incomes are expected to benefit from a robust labour market and rising real wages, which are set to support private consumption over the forecast horizon.

Overall, real GDP is forecast to increase by 0.3% in 2024 and 1.2% in 2025. For 2024, this implies a downward revision from 0.8% projected in the Autumn Forecast, while the forecast for 2025 remains unchanged.

Graph 2.2: **Germany - Real GDP growth and contributions**

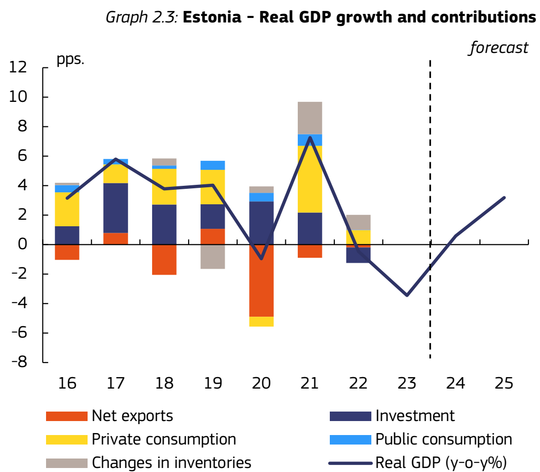


HICP inflation decelerated from its peak of 11.6% in October 2022 to 6.0% in 2023 as a whole and to 3.1% in January 2024. This reduction is mainly driven by the decline in wholesale energy prices and the introduction of energy support measures, which were discontinued in November 2023. HICP inflation is projected to reach 2.8% in 2024 and 2.4% in 2025. This is broadly in line with the Autumn Forecast. Inflation in both years is forecast to be driven mainly by the services sector, where wage growth is temporarily keeping inflation elevated as expected in the Autumn Forecast 2023. By contrast, energy price growth is set to contribute only slightly to inflation going forward.

2.3. ESTONIA

Estonia's real GDP is estimated to have contracted by 3.5% in 2023, more than projected in autumn, with the downturn becoming broad-based and affecting not only investment but also private consumption and, particularly, exports. The latter were impacted by weak external demand and depreciations of major trading partners' currencies. Despite the two-year recession, the labour market continued to be remarkably resilient in 2023. The unemployment rate remained low, while employment increased in the second half of the year. Wages grew strongly, though not yet fully compensating for the purchasing power lost due to high inflation over the last years.

Graph 2.3: **Estonia - Real GDP growth and contributions**



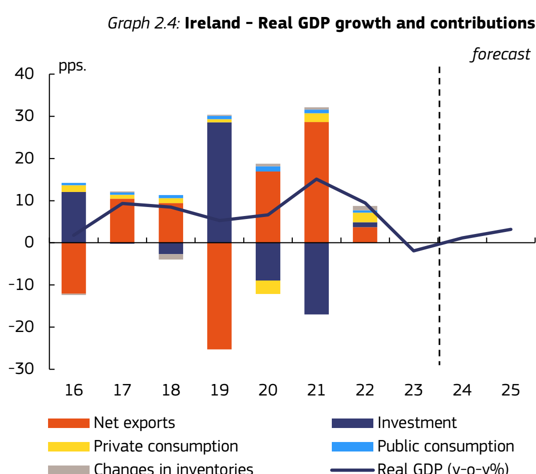
Early indicators point to a weak start of 2024. Business confidence moved sideways in pessimistic territory over the last few months, with some improvement in industry and construction, but worsening in the retail sector. Consumers expect their financial situation to deteriorate due to the higher VAT and excise taxes applied as of 2024, still elevated inflation, and high borrowing costs. This suggests that domestic demand is set to be very modest in the first half of the year. Combined with subdued external demand from the country's main trading partners, this prompts a large downward revision of real GDP growth in 2024, to 0.6%, compared to 1.9% in the Autumn Forecast. In 2025, growth is expected to resume on the back of an improving external environment, more favourable financing conditions and rising consumption, as purchasing power is restored through the combination of falling inflation and rising wages. It is projected at 3.2%, higher than in the Autumn Forecast.

Estonia recorded 9.1% HICP inflation in 2023, down from double digits in the first half of the year but still above 4% in the last quarter, despite significantly falling global energy prices and moderation in food and industrial goods inflation. The higher VAT applied as of 1 January 2024 is set to keep prices high, but inflation is expected to gradually decline in line with global trends, averaging 3.2% in 2024 and 1.9% in 2025. This is slightly lower than in the Autumn Forecast for both years.

2.4. IRELAND

Real GDP in Ireland declined by 1.9% q-o-q in the third quarter of 2023, extending the recession observed in the first half of the year. This downturn was primarily influenced by sustained weakness in pharmaceutical exports and contract manufacturing activity by multinational enterprises. In contrast, modified domestic demand, which better reflects underlying domestic activity, was broadly unchanged in the third quarter. Consumer spending remained resilient, supported by a strong labour market, while the moderation of previously strong physical investment in 2022 acted as a drag on economic activity. Preliminary estimates suggest a continued decline in real GDP during the fourth quarter of 2023, by 0.7% q-o-q, bringing the contraction in GDP to 1.9% in 2023 as a whole, compared to 0.9% in autumn.

Graph 2.4: **Ireland - Real GDP growth and contributions**



A resilient labour market, decelerating inflation and rising real incomes are expected to underpin further private consumption growth in 2024 and 2025. Investment is set to grow only moderately in 2024 due to a muted demand outlook and to pick up pace in 2025 as financial conditions continue to ease. Ongoing increases in both housing completions and starts suggest that dwelling investment remains strong over the forecast horizon.

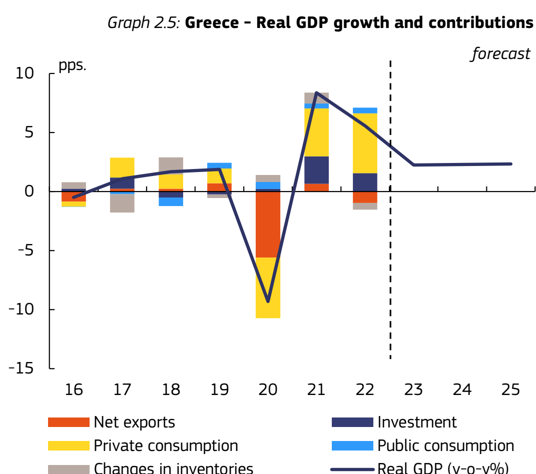
The export outlook is expected to be positive in 2024 and 2025, supported by an improvement in external trade conditions coupled with recent large-scale investments. GDP growth in 2024 has been revised down substantially to 1.2% compared to 3.0% in the Autumn Forecast, mainly reflecting a lower-than-projected carry-over from 2023. In 2025, economic activity is expected to expand by 3.2%, slightly lower than in the Autumn 2023 Forecast.

HICP inflation decelerated notably in the final months of 2023, largely driven by the pass-through of falling wholesale energy prices to consumers. Annual inflation in 2023 averaged 5.2% and is projected to ease further over the forecast horizon as energy prices and commodity prices recede. Domestic price pressures are expected to continue, driven by sustained tightness in the labour market. Overall inflation is projected at 2.2% in 2024 and 1.9% in 2025, lower than forecast in autumn.

2.5. GREECE

Greece's real GDP is estimated to have grown by 2.2% in 2023, slightly lower than in the Autumn Forecast. Following the strong recovery in 2022, consumption growth decreased substantially but remained one of the main growth drivers last year. Despite tightening financing conditions, investment made a significant contribution, thanks to strong construction activity and the implementation of the Recovery and Resilience Plan (RRP). The slower than expected recovery of Greece's key EU trade partners weighed on export growth, still net exports had a positive contribution to growth.

Graph 2.5: **Greece - Real GDP growth and contributions**



Economic growth is expected to remain broadly stable at 2.3% in 2024 and 2025, broadly as expected in autumn. Real consumption is set to expand at similar

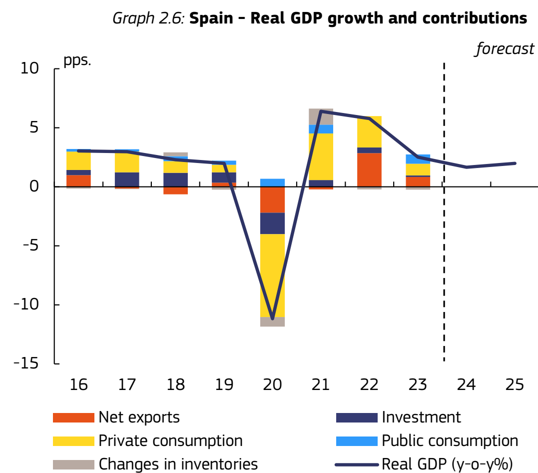
rates as in 2023, resulting in a slightly lower contribution to real GDP growth. Investment is expected to pick up sizeably as the RRP implementation gains speed, and as financing conditions ease. The composition of gross fixed capital formation is projected to shift from construction to more productive investments such as equipment and machinery. However, investments are likely to induce higher import demand for both goods and services, which is projected to reduce the positive contribution of net exports in 2024-25.

Annual HICP inflation moderated to 4.2% in 2023. Underlying inflation excluding energy and food prices was substantially higher, at 5.3% in 2023 on average, but declined below the level of HICP inflation by December 2023. This reflects a progressive moderation of demand pressures on core prices and lower-than-expected pass-through of previous energy and food price shocks. The tightening labour market, together with the recently announced minimum wage increase (as from April 2024), is expected to put some upward pressure on prices, which would partly offset the impact of lower energy prices on inflation. Overall, HICP inflation is expected to decline more gradually in 2024 and 2025, to 2.7% and 2% respectively. This is marginally lower than in the Autumn Forecast in both years.

2.6. SPAIN

The Spanish economy is estimated to have expanded by 2.5% in 2023, marginally above what was projected in autumn, with preliminary data for the fourth quarter pointing to an acceleration (0.6% q-o-q) compared to the third quarter. Private consumption and, to a lesser extent, investment were the key drivers of GDP growth throughout 2023. External demand, which contributed negatively to economic expansion in the second and third quarters of last year, picked up in the fourth quarter.

Graph 2.6: **Spain - Real GDP growth and contributions**



Real GDP growth is forecast to moderate to 1.7% in 2024, unchanged from autumn, owing to the combination of several factors. On the external side, the fading impetus of the tourism sector and the still weak economic situation in Spain's main trading partners are projected to limit the dynamism of exports. On the domestic front, the lagged impact of interest rate hikes is set to weigh on domestic demand, especially in light of the still elevated, albeit declining, internal and external debt-to-GDP ratios.

Still, consumption and investment are set to sustain the economic expansion this year, also benefitting from a higher-than-anticipated carry-over from 2023. Private consumption is expected to be supported by further real income gains for households and by the partial use of the still high level of household savings. After the buoyancy showed in 2023, employment growth is projected to decelerate this year, but will still contribute to sustaining economic activity. Investment growth is expected to be underpinned by the broadening implementation of the Recovery and Resilience Plan. It will also be upheld by the healthy financial position of non-financial corporations and the expected easing of financing conditions over the forecast horizon. GDP growth is set to accelerate again in 2025, to an unrevised 2.0%, on the back of reinvigorated investment growth and the projected positive contribution from external demand.

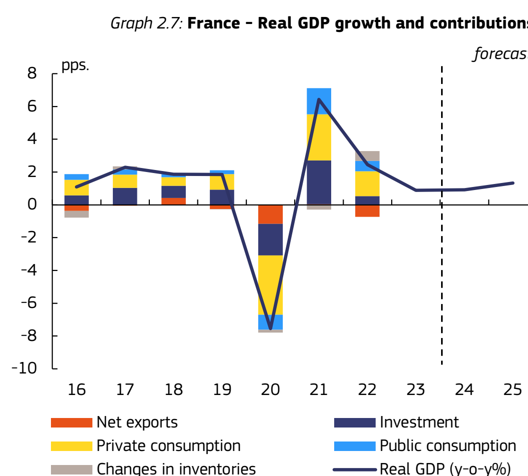
Annual HICP inflation decelerated to 3.4% in 2023, favoured by the sustained decline in energy prices throughout the year. Underlying price pressures eased more gradually as the pass-through of high energy prices to other items faded out in the last quarter of 2023. Headline inflation is set to moderate further this year, reaching 3.2% on average, with the downward trend of underlying price pressures expected to continue in the coming quarters. At the same time, the expected phasing out of most government measures to mitigate the impact of high energy prices would exert upward pressure on inflation. HICP inflation is forecast to

decrease further to 2.1% in 2025. For 2024, this is slightly lower than in the Autumn Forecast, while the forecast for 2025 remains unchanged.

2.7. FRANCE

GDP is estimated to have grown by 0.9% in 2023, driven by strong growth in the second quarter. This is marginally below the Autumn 2023 Forecast. High inflation and tighter financial conditions weighed on growth throughout the year despite government support measures and a very favourable labour market, accompanied by dynamic wages that preserved households' purchasing power. While net exports contributed positively to growth, these were fuelled mostly by a decrease in imports of goods, as the growth of domestic demand was limited.

Graph 2.7: **France - Real GDP growth and contributions**



In 2024, GDP is expected to grow moderately, by 0.9% annually, a downward revision of 0.3 pps. compared to the Autumn Forecast. The revision can be mainly attributed to a lower carry-over from a weaker than expected second half of 2023. Economic activity is expected to gather momentum in the second half of 2024. Private consumption is set to drive GDP growth on the back of rapidly declining inflation. Investment is expected to remain subdued until the second half of the year due to still restrictive financing conditions but is then set to start recovering. Net exports are projected to make no contribution to GDP growth given that imports are set to rise - pushed by strong demand - while exports of goods are only expected to progressively catch up with their pre-crisis level.

In 2025, GDP growth is forecast at 1.3%, marginally below the Autumn Forecast. Economic activity is expected to be further driven by private consumption as inflationary pressures dissipate, and households' saving rate declines gradually towards its historical average. Investment from both households and corporations is projected to recover progressively. Net exports are set to have a limited contribution to growth, with strong exports growth offset by rising imports as domestic demand expands.

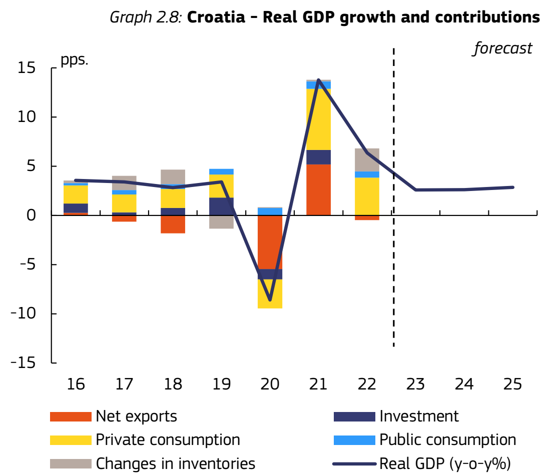
After peaking at 7.0% in the first quarter of 2023, HICP inflation decreased throughout the year to reach 4.2% in the fourth quarter, largely thanks to declining energy and commodity prices. The progressive phasing-out of energy-related measures and the increase of the electricity tax in February 2024, to roughly two-thirds of its pre-crisis level, will lead to an increase in electricity prices of close to 10%. Meanwhile, wage increases are still set to feed underlying price pressures. However, the downward trend in inflation is set to continue over the forecast horizon. After 5.7% in 2023, inflation is expected to reach 2.8% in 2024 and 2.0% in 2025. For 2024, this is slightly lower than in autumn, while the forecast for 2025 remained unchanged.

2.8. CROATIA

Croatia's GDP growth is estimated to have remained robust in 2023, at 2.6%, unchanged compared to the Autumn 2023 Forecast. Economic activity was supported by domestic demand. Private consumption benefited from favourable wage developments and strong consumer sentiment, while monthly retail trade data point to an acceleration in the fourth quarter. Strong investment growth was supported by EU funds, including those under the 2014-20 multiannual financial framework, which had to be absorbed by the end of 2023. While exports of goods declined last year due to weak external demand, overall (net) trade contributed positively to growth amid strong services exports (mainly tourism) following the euro adoption and accession to the Schengen area at the beginning of 2023.

In 2024, real GDP is forecast to also grow by 2.6%, mainly on account of strong domestic demand, and reflecting significant carry-over effects. This is marginally above the Autumn Forecast. Household consumption growth is set to accelerate as inflation abates and employment and real wages continue to increase. Significant support to wage growth is expected from the government sector, where considerable (one-off) increases are envisaged from the public sector wage-setting reform. Investment and public consumption growth are forecast to decelerate, but remain solid, also in light of the continued implementation of the Recovery and Resilience Plan and the expected easing of financing conditions. After reaching comparatively high levels, growth of services exports is forecast to slow down, while exports of goods are projected to grow again with the progressive recovery of external demand. Due to higher imports growth, net exports are however expected to provide a small negative contribution to GDP growth. In 2025, GDP growth is forecast at 2.8%, unchanged from autumn, and set to remain broad-based. Some rebalancing is expected, with the positive contribution of domestic demand likely to decline, and foreign trade adding to growth amid further strengthening of exports.

Graph 2.8: **Croatia - Real GDP growth and contributions**



HICP inflation declined to 8.4% in 2023, from 10.7% in 2022, while inflation excluding energy and food was 8.8%. Both exceeded the corresponding euro area rates of 5.4% and 5%, respectively. The deceleration of HICP inflation over 2023 was mainly driven by energy and processed food prices. Services inflation proved to be more persistent, with a considerable contribution coming from services related to tourism, largely reflecting foreign demand. HICP inflation is forecast at 2.5% and 2% in 2024 and 2025, with the prices of energy and unprocessed food expected to drive the downward trend, while services inflation is projected to remain stickier. Compared to autumn, this is broadly unchanged for 2024 but revised up for 2025. There is a risk of a slower-than-expected decline in inflation due to wage cost pressures, especially if these are not absorbed by firm profits.

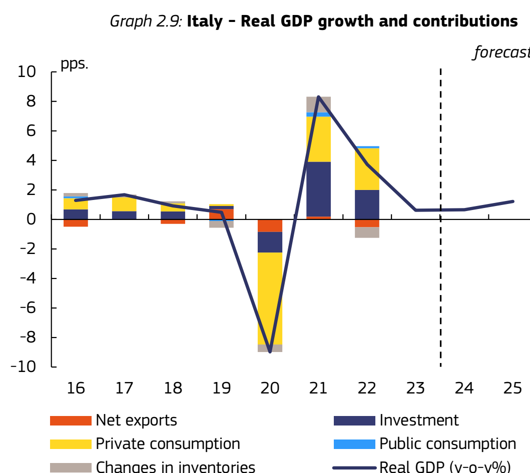
2.9. ITALY

Real GDP is estimated to have grown by 0.6% in 2023, marginally below the Autumn 2023 Forecast, as private consumption moderated and investment slowed down considerably, due to rising financing costs and the phasing out of housing renovation tax credits. After decreasing by 0.3% in the second quarter, GDP edged up in the third and fourth quarters, providing a marginally positive carryover into 2024.

Economic output is forecast to continue growing slowly in 2024, with households' purchasing power expected to benefit from disinflation and an increase in wages, against the background of a resilient labour market. Investment is set to recover, driven by government and RRF-funded infrastructure projects offsetting the drag from lower expenditure on housing construction. Annual GDP is projected to grow by 0.7% in real terms, slightly lower than expected in autumn.

Investment is expected to accelerate in 2025, as the implementation of RRF-backed projects gathers pace, boosting both infrastructure spending and the purchase of firms' tangible and intangible assets, which is also anticipated to benefit from improving financial conditions. This surge in capital spending is set to translate into stronger growth of imports, above the mildly improving outlook for exports. Overall, real GDP is forecast to increase by 1.2% in 2025, unchanged compared to autumn.

Graph 2.9: **Italy - Real GDP growth and contributions**

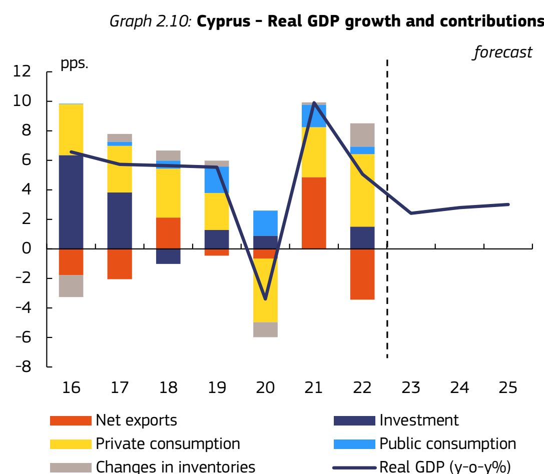


HICP inflation decreased steadily last year from the 2022 peak, driven by rapidly falling energy prices gradually passing through to the other goods, but also by the limited increases in services inflation. In the fourth quarter of 2023 inflation fell back to 1% y-o-y and stayed below 1% in January. Moderate wage increases have so far helped to keep inflation in check. As the main collective labour contracts are being gradually renewed, workers are expected to recover the past losses of purchasing power. HICP inflation is projected at 2.0% in 2024 and at 2.3% in 2025 on the back of an expected pick-up in wages, led by the public sector. Compared to autumn, this is revised down for 2024 but remains unchanged for 2025.

2.10. CYPRUS

Real GDP growth in Cyprus slowed down to 2.5% in the first three quarters of 2023 (y-o-y) compared to 5.8% for the same period of 2022, mainly due to a lower external demand for non-tourism services. Still, demand for tourism services continued its rebound in 2023, with arrivals increasing by 20.1%, almost reaching pre-pandemic levels. Private consumption remained robust, supported by real wage increases and continued employment growth, 1.6%. For the whole of 2023, economic activity is expected to have grown by 2.4%, slightly higher than in the Autumn 2023 Forecast, following 5.1% in 2022.

Graph 2.10: **Cyprus - Real GDP growth and contributions**



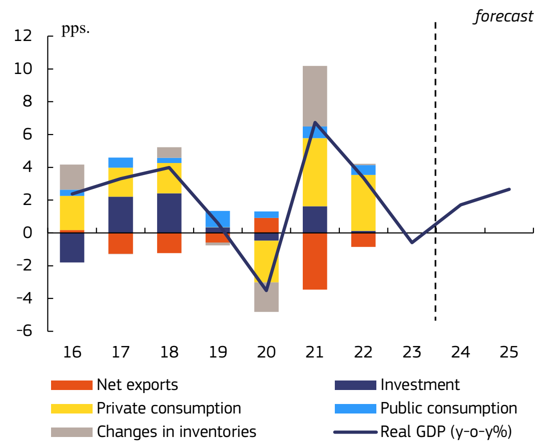
In 2024 and 2025, real GDP is expected to grow by 2.8% and 3% respectively, slightly stronger than forecast in autumn for both years. Economic sentiment among consumers and businesses slightly improved in January 2024. Domestic demand is expected to continue being the main driver for real GDP growth in 2024 and 2025, as automatic wage indexation for around half of the employees (covered by collective agreements in the public and private sector) holds up their purchasing power. Large investment projects in real estate, healthcare, transport and tourism, partly supported by the Recovery and Resilience Facility, are also set to boost growth. By contrast, the contribution of net exports is expected to remain weak due to the ongoing economic uncertainty in Cyprus' main trading partners and to the strong import demand induced by investments.

HICP inflation slowed down to 3.9% in 2023, from 8.1% in 2022, mainly reflecting lower energy prices. HICP inflation is set to moderate to 2.4% in 2024 and to 2.1% in 2025, in line with an assumed continued expected decline in prices for energy and other commodities. By contrast, wage indexation is expected to exert some upward pressure on HICP inflation excluding energy and food. Compared to autumn, the forecast for HICP inflation is revised down for 2024, but is broadly unchanged for 2025.

2.11. LATVIA

Real GDP is estimated to have contracted by 0.6% in 2023. This is a greater contraction than projected in the Autumn Forecast and is explained by negative growth in the first two quarters and a very modest rebound in the second half of the year. Private consumption and exports slowed down markedly in 2023, whereas investment and public consumption expenditure showed strong growth. The labour market remained strong, with wage growth above inflation supporting real disposable incomes.

Graph 2.11: **Latvia - Real GDP growth and contributions**



Wage increases are set to decelerate in 2024 but are still expected to support a rebound in private consumption over the forecast horizon, as inflation is assumed to significantly ease. Additionally, EU-funded investments, including those financed by the RRF, as well as other public expenditure, are projected to remain strong in 2024. Export growth is forecast to remain slightly negative in 2024, mostly due to the effect of a negative carry-over. Overall, economic activity is set to recover in 2024 at a rate of 1.7%, below the 2.4% projected in the Autumn Forecast.

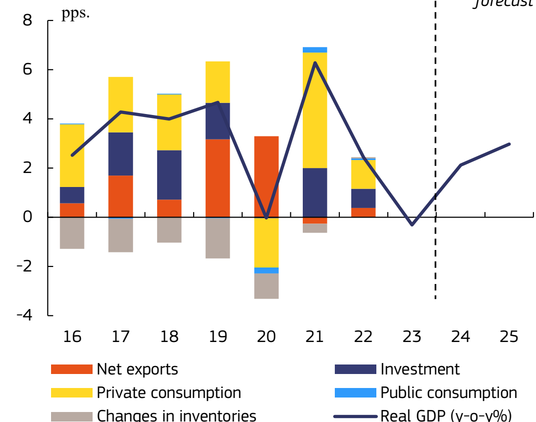
In 2025, growth is forecast to accelerate to 2.7%, slightly below the Autumn 2023 Forecast, driven by domestic demand. Investments should remain particularly strong, supported by EU-fund inflows and easing of financial conditions. Export growth is projected to pick up, in line with a general improvement in demand from main trading partners.

HICP inflation rapidly decelerated in the second half of 2023, driven by declining energy prices. However, the pass-through of high energy prices to other components, in particular services, accelerated during the year. Headline inflation averaged a still elevated level of 9.1% in 2023, with inflation excluding unprocessed food and energy posting 9.7%. In 2024, headline inflation is forecast at 2.2%, below the Autumn Forecast, as energy prices are expected to further decline. Inflation excluding unprocessed food and energy is set to remain above headline inflation, driven by price increases in services and processed food. In 2025, HICP inflation is projected to remain at 2.2%, slightly higher than in autumn, reflecting a slower disinflationary process.

2.12. LITHUANIA

Real GDP is estimated to have contracted by 0.3% in 2023, slightly less than expected in autumn. After a negative first quarter, real GDP strongly rebounded in the second quarter, before stagnating in the second half of the year. Despite significant capital investments and a fast deceleration of inflation, the economic recovery was delayed due to subdued private consumption, weak exports and tightening financing conditions. Exports of goods, in particular in the chemical, plastic, wood and furniture sectors, continued to be impacted by sluggish global demand, while exports in services recovered. The labour market remained resilient, with unemployment on a downward trend and growing employment figures thanks to an increasing number of self-employed and persons fleeing war in Ukraine. Wage growth remained strong,

Graph 2.12: **Lithuania - Real GDP growth and contributions**



driven by higher minimum wages and public sector wage increases, but also due to a persistently tight labour market.

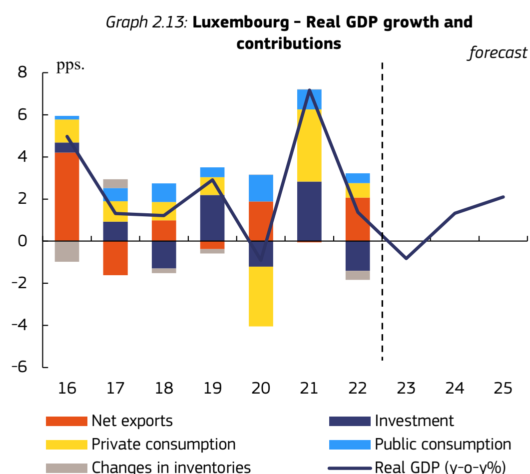
While recent manufacturing, construction and services confidence indicators show rather pessimistic expectations for the near future, consumer confidence started to improve. Private consumption is expected to grow thanks to alleviating price pressures, although uncertainty over Russia's war of aggression in Ukraine is still expected to weigh on private consumption, as consumers opt for precautionary savings instead. At the same time, continuously weak external demand is limiting growth, which is forecasted at 2.1% in 2024. For 2025, GDP growth is projected to strengthen to 3%, as exports are recovering, and private consumption and investments are expected to become the key growth drivers.

After reaching a record-high of 18.9% in 2022, HICP inflation moderated to 8.7% in 2023, as growth in prices of energy turned negative in the second half of 2023, while the price of food and manufacturing products continued to decelerate. For 2024-25, HICP inflation is forecast to come down faster than projected in the Autumn Forecast, mainly due to a stronger-than-expected decline in energy prices. HICP inflation is projected to remain slightly above the 2% target, at 2.4%, over the forecast horizon. Inflation excluding energy and food should come down as well, albeit somewhat slower than headline inflation. Wage growth is expected to slow down from the double-digit growth of 2023, but to remain significant due to the tight labour market and expected minimum wage increases.

2.13. LUXEMBOURG

The economy of Luxembourg slowed down markedly in 2023, with GDP contracting in the second and third quarters. Overall, economic activity is estimated to have decreased by 0.8% in 2023, slightly more than expected in autumn, mainly affected by a contraction in financial services and in the construction sector. Private consumption, held up by lower inflation and government support measures, and public consumption, drove up domestic demand.

Graph 2.13: **Luxembourg - Real GDP growth and contributions**



Economic activity is projected to recover in 2024, with GDP growth forecast at 1.3%. Private consumption is expected to be supported by receding inflationary pressures, rising wages, reduced personal income tax, the impact of the government's support package *Solidaritéitspak 3.0* and a moderate easing of financing conditions over the forecast horizon. In addition, consumers' confidence improved in the latest survey. Investment is expected to remain at relatively low levels as a result of the projected decline in activity in the construction sector, as also indicated by business surveys.

In 2025, economic growth is set to pick up further, reaching 2.1%. Private consumption will continue to be supportive as energy and food prices are expected to further ease. In addition, looser financing conditions are projected to support the financial sector, thereby enhancing exports of services, and investment particularly in the construction sector, both contributing to higher growth. These forecasts are broadly unchanged compared to the Autumn 2023 Forecast.

HICP inflation fell to 2.9% in 2023, mainly on the back of lower energy prices. In addition, even though three rounds of wage indexations were triggered, services' price inflation registered a slowdown, reflecting the gratuity of some services such as school canteens, introduced in September 2022. Food and energy inflation are expected to continue decreasing over the forecast horizon, resulting in a deceleration of headline inflation. For both 2024 and 2025, one round of wage indexation is projected. Overall, HICP inflation is estimated at 2.6% in 2024 and 2.3% in 2025. Compared to autumn, this is revised down for 2024 but up for 2025.

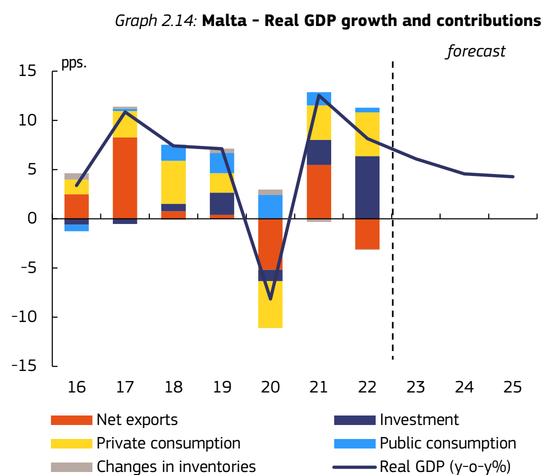
Inflation excluding energy and food is forecast to gradually decrease from its peak in 2023, albeit remaining above HICP inflation.

2.14. MALTA

After exceptional growth in 2022 (8.1%), real GDP growth is estimated to have remained strong at 6.1% in 2023. This is higher than projected in the Autumn Forecast and is due to upward revisions of economic activity in the first two quarters of last year and high growth of 2.4% in the third. Private consumption and net exports grew strongly. By contrast, gross fixed capital formation declined, amid weaker construction activity in 2023. The base effect of the acquisition of aircrafts in 2022 also weighed on investment growth. Growth in the last quarter of 2023 is estimated to have been moderate given an expected recovery of imports to support strong domestic demand at the end of the year.

In 2024, growth is revised up compared to autumn, to 4.6%. It is set to be driven by net exports and private consumption, which should continue to grow strongly even if at lower rates than in the previous two years. Investment growth is expected to pick-up after the construction slowdown and public consumption is set to remain strong. Growth in 2025 is forecast at 4.3%, broadly unchanged from autumn, with the growth rate of consumption, investment and net exports stabilising at slightly lower levels in comparison to 2024.

Graph 2.14: **Malta - Real GDP growth and contributions**



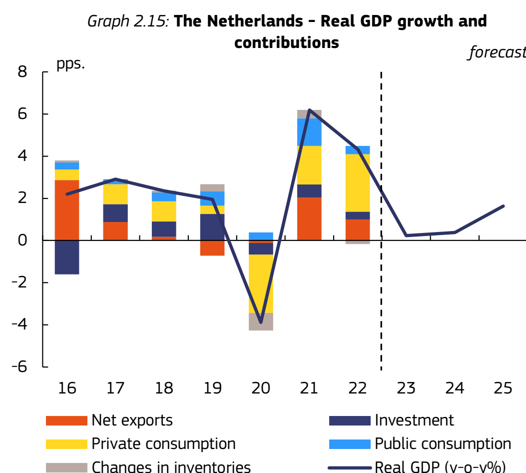
HICP inflation in 2023 reached 5.6%, despite energy prices being kept at 2020 levels by government intervention. Inflation in 2024 and 2025 is forecast at 2.9% and 2.7% respectively, with continuing pressures in food and services prices while retail energy prices are set to remain stable due to government intervention. These forecasts are lower than in the Autumn 2023 Forecast.

2.15. THE NETHERLANDS

The Dutch economy slowed down markedly in 2023, with GDP contracting over the first three quarters of the year. The impact of high inflation rates on households' disposable incomes resulted in a significant decrease in private consumption spending. At the same time, export volumes decreased due to a slowdown in economic activity in the Netherlands' main trading partners. Investment proved to be volatile, with a still robust first half of the year, but with businesses cutting back on investment spending in the third quarter. Annual growth in 2023 is estimated at 0.2%, a downward revision compared to the Autumn 2023 Forecast.

Private consumption is set to recover somewhat in 2024, as real wages pick up due to decreasing inflation rates and strong nominal wage growth. Furthermore, growth in 2024 is expected to be supported by increased government investment spending. Private investment is set to remain weak due to labour shortages and businesses continuing to adjust to the tightening of financial conditions that took place in 2023. Overall, growth in 2024 is forecast at 0.4%, revised significantly downwards compared to the Autumn Forecast. This can be explained by a more substantial negative carry-over effect into 2024 due to a downward revision of growth in the first three quarters of 2023. Growth is projected to pick up to 1.6% in 2025, broadly unchanged compared to autumn, on the back of a further recovery in private consumption and an improved outlook for trade and investment.

Graph 2.15: **The Netherlands - Real GDP growth and contributions**



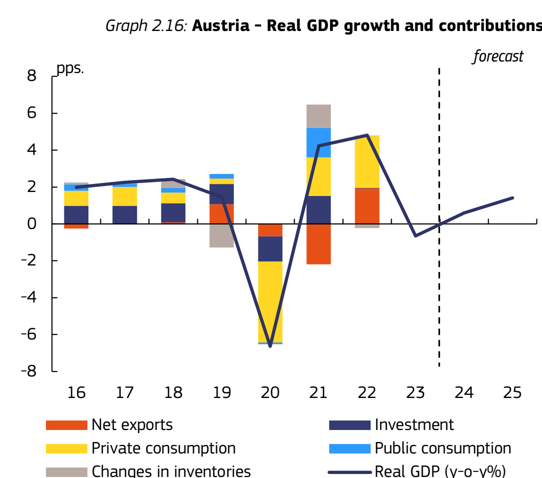
HICP inflation came down significantly during 2023, from 7.2% in the first quarter to 0.4% in the fourth quarter. The exceptionally low inflation in the fourth quarter can mainly be attributed to a strong decrease in energy prices. In the beginning of 2024, headline inflation is set to bounce back to around 3%, as the year-on-year comparison for energy prices becomes less favourable. Inflation excluding energy and food prices is forecast to continue gradually easing throughout 2024 and 2025, as strong wage growth prevents a steeper drop in inflation rates. Overall, HICP inflation is forecast at 2.6% in 2024 and 2.0% in 2025, which represents a strong downward revision for 2024, while the forecast for 2025 remains unchanged from autumn.

2.16. AUSTRIA

The Austrian economy is estimated to have contracted by 0.7% in 2023, slightly more than expected in autumn, due to weaker private consumption and investments. Private consumption suffered from a loss in households' purchasing power in a context of high inflation. Investments, especially in the construction sector, were constrained by the tightening of financing conditions. Moreover, industrial production was dragged down by high energy prices. In contrast, the tourism sector experienced a boom despite elevated prices. The economic slowdown in 2023 was most pronounced in the second quarter (-1.1% q-o-q). It continued in the third quarter (-0.5% q-o-q) before activity picked up in the fourth quarter (+0.2% q-o-q). The most recent economic sentiment indicators remain stable but are substantially below their long-term average.

The economic recovery is projected to be gradual, with growth increasing slightly in 2024 and picking up more strongly in 2025. Private consumption is expected to be the main growth driver, underpinned by stable levels of employment and strong real wage increases following recent collective wage agreements. As financing conditions are expected to ease over the forecast horizon, growth is also set to benefit from increasing investments from the second half of 2024 onwards. Import growth is projected to outperform export growth in light of the rebound of domestic demand and a delayed economic recovery in Austria's main trading partners such as Germany. Therefore, trade is not forecast to contribute to growth. Overall, the Austrian economy is forecast to grow by 0.6% in 2024 and 1.4% in 2025. For 2024, this implies a downward revision of 0.4 pps. compared to the Autumn Forecast, while the forecast for 2025 remains broadly unchanged.

Graph 2.16: **Austria - Real GDP growth and contributions**

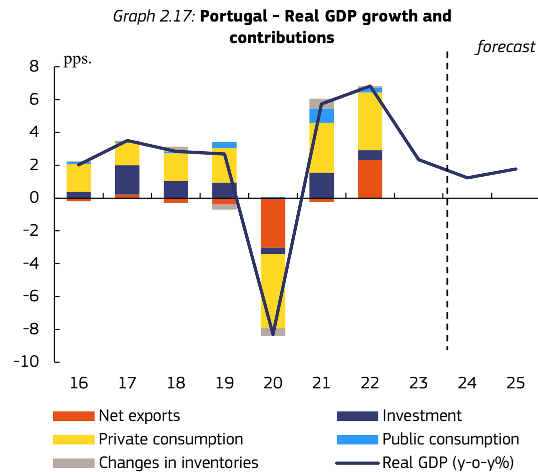


HICP inflation is estimated to have peaked at an annual rate of 7.7% in 2023 and is expected to gradually decline to 4.0% in 2024 and 3.0% in 2025, broadly unchanged compared to autumn. The rapid slowdown in 2024 is driven particularly by a stabilisation of energy prices at lower levels. Wage growth is set to temporarily exert a certain upward pressure on prices, notably in services. However, corporate profitability has been strong in the recent past, hence there should be room to partly accommodate wage growth.

2.17. PORTUGAL

Portugal's economy picked up in the last quarter of 2023 amid a slight recovery of economic sentiment and solid employment growth. According to the flash estimate, GDP rose by 0.8% (q-o-q) in 2023-Q4 after shrinking by 0.2% in the previous quarter. In full-year terms, economic growth slowed from 6.8% in 2022 to 2.3% in 2023, broadly as expected in autumn. The slowdown was initially triggered by private consumption and investment, reflecting the impact of higher interest rates. In the second half of the year, both consumption and investment rebounded while the contribution of net exports to growth turned negative on the back of weaker growth in foreign tourism and a drop in exports of goods.

Graph 2.17: **Portugal - Real GDP growth and contributions**



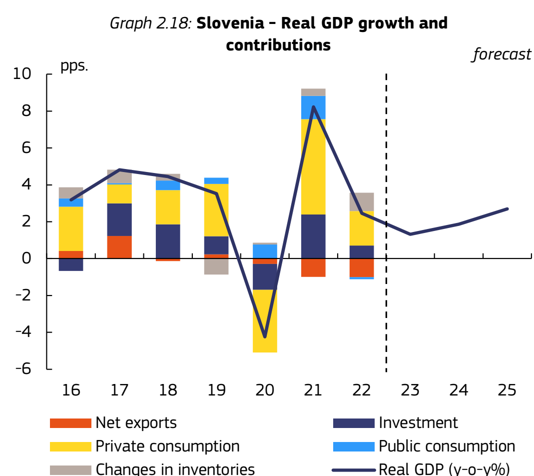
In light of weak demand by main trading partners, economic growth is projected to remain subdued at the beginning of 2024 and to pick up only gradually afterwards. In full-year terms, GDP growth is forecast at 1.2% in 2024 and 1.8% in 2025, broadly unchanged compared to the Autumn Forecast. Private consumption is set to benefit from a steady increase in employment and wages, largely offsetting higher household expenses on mortgage interest payments, while the ongoing implementation of the Recovery and Resilience Plan continues to support investment. In the external sector, imports are expected to outpace exports.

HICP inflation slowed considerably in 2023, moving down from a peak of 10.2% (y-o-y) in 2022-Q4 to 2.4% (y-o-y) in 2023-Q4. Energy prices contributed substantially to disinflation, helped at a later stage by food and non-energy industrial goods. Services inflation remained elevated, mainly due to accommodation and catering services, but decelerated towards the end of the year after having reached a peak in the summer months.

HICP Inflation is projected to decline further over the forecast horizon, driven by declining energy prices and lower increases in food commodities. Service prices are also poised to contribute to disinflation but at a much slower pace, as the expected wage and employment growth is set to support consumer demand. In the first half of 2024, the disinflation process is expected to be temporarily muted by base effects in the energy sector and the re-establishment of the normal VAT rates for essential food products. All in all, annual HICP inflation is forecast to drop from 5.3% in 2023 to 2.3% in 2024 and 1.9% in 2025, which is lower than the Autumn Forecast for both years.

2.18. SLOVENIA

Overall, Slovenia's real GDP is estimated to have expanded by 1.3% in 2023, as expected in autumn. Over the first three quarters of the year, private consumption growth was modest while construction investment growth proved very strong. Machinery and equipment investments, on the other hand, decreased. Imports declined significantly faster than exports, leading to a positive contribution from net exports. Employment has remained strong through the year.



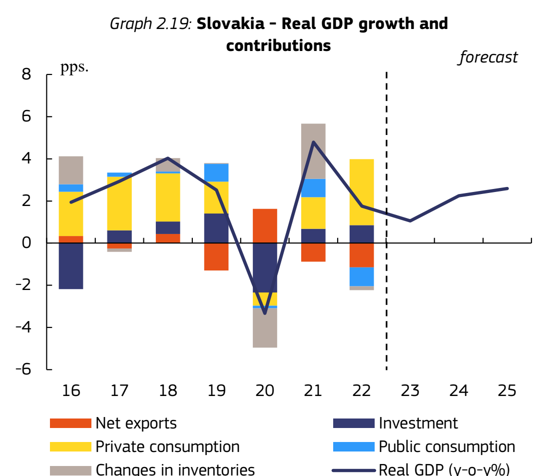
GDP is forecast to expand by 1.9% in 2024 and by 2.7% in 2025, broadly unchanged compared to the Autumn Forecast. Weak sentiment and low exports demand are expected to limit growth in the beginning of 2024. With continued strong investment, also supported by the RRP, and recovery of demand in exports markets, growth is projected to improve over the forecast horizon. Private and public consumption are expected to pick up thanks to the continued strong labour market performance and increasing wages. In 2025, private consumption is set to grow faster than in 2024. Net exports are forecast to be broadly neutral, while the volume in trade is projected to grow significantly faster than in 2024.

HICP inflation decreased markedly over 2023, especially in energy. In the final quarter of the year, also food price inflation started to decelerate. Overall, inflation averaged 7.2% in 2023. Headline inflation is projected to decrease to 2.9% in 2024, on the back of moderating energy prices and relatively weak demand. In 2025, despite continued wage pressures, HICP inflation is forecast to fall further to 2.0%. For both years, this is a downwards revision compared to autumn. Similarly, inflation excluding energy and food is projected to be on a downward trend over the forecast horizon.

2.19. SLOVAKIA

Economic growth in Slovakia slowed down in 2023 driven by the decline in private and public consumption. The weakening of the economic outlook in the country's major export destinations resulted in a decline of exports and imports, accompanied by a drawdown in inventories. Real GDP is estimated to have grown by 1.1% in 2023, slightly below the Autumn Forecast.

Going forward, a real wage increase should provide an extra stimulus for private consumption, as government measures are expected to continue to shelter consumers from the impact of high energy prices in 2024. The increase in real incomes is also likely to extend into 2025. Exports are expected to increase over the forecast horizon, as the economic situation in major export destinations is assumed to improve. The absorption of EU funds is seen as a strong contributor to investment growth in 2024 and 2025. Financing conditions are expected to ease further over the forecast horizon but to remain relatively tight, somewhat dampening private investments. Against this backdrop, economic growth is overall projected at 2.3% in 2024 and 2.6% in 2025. This implies a significant upward revision by 0.6 pps. in each year compared with the Autumn Forecast, due to an expected pick-up in private consumption and investment.

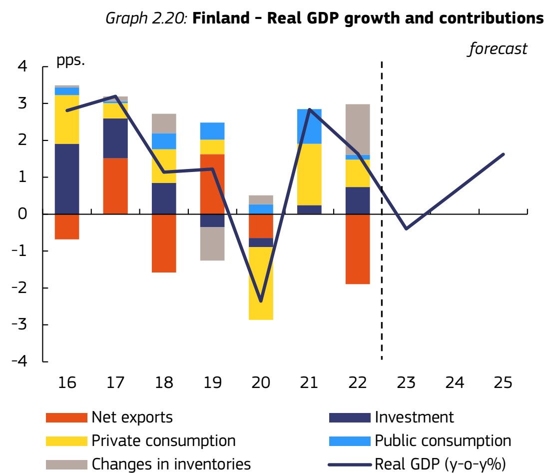


HICP inflation reached 11% in 2023 due to high energy prices and their pass-through to other components. The inflation rate is set to drop to 3.5% in 2024 as growth in energy and consumer food prices is expected to strongly moderate over the forecast horizon. However, the protracted impact of energy prices and a tight labour market are set to exert upward pressure on prices in the service sector. In 2025, HICP inflation is expected to further decline to 2.6%. For both years, these forecasts have been revised down compared to autumn. Government measures to mitigate the impact of high energy prices, which were extended into 2024, are assumed to be phased out in 2025.

2.20. FINLAND

Finland's economy is estimated to have contracted by approximately half a percent in 2023. Private consumption started declining already in the second quarter, while higher interest rates and input costs weighed on investment, especially construction. By contrast, general government consumption increased and net exports are projected to have had a positive contribution to growth, as the decline in imports more than offset the fall in exports. Subdued import demand can be explained by lower domestic demand and previously accumulated large stock of inventories.

Graph 2.20: **Finland - Real GDP growth and contributions**



The start of this year is marked by weak business and consumer sentiment, and growth in the first quarter of 2024 is forecast to be sluggish. However, the projected fall in inflation, rising wages and income tax cuts that took effect at the start of the year are set to support consumers' purchasing power. Together with more favourable financing conditions and a relatively stable labour market situation, this is expected to pave the way for a recovery in the second half of the year. Hence, private consumption is forecast to be the main growth driver this year, followed by exports. Domestic demand is set to strengthen further in 2025, when investment growth is expected to pick up on the back of a reviving construction sector. Overall, real GDP growth is projected at 0.6% in 2024 and to accelerate to 1.6% in 2025. Compared to the Autumn Forecast, the projection for 2024 is revised down while 2025 remains broadly unchanged.

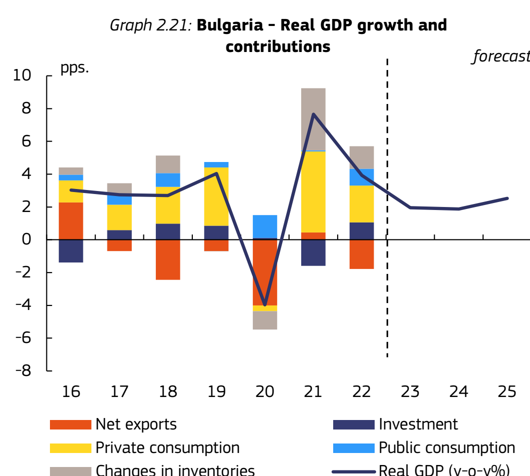
In 2023, HICP inflation dropped to 4.3%, from 7.2% in 2022. A decline in energy prices, especially in the last quarter of 2023, was the main factor behind easing price pressures. The continuous pass-through of falling energy prices, the tight monetary stance and weak economic growth are set to exert further downward pressure in 2024. Overall, HICP inflation is projected to fall to 1.4% in 2024, and to slightly increase to 1.5% in 2025 as economic growth is set to pick up. For both years, these forecasts have been revised down compared to autumn.

NON-EURO AREA

2.21. BULGARIA

In 2023, the Bulgarian economy is estimated to have grown by 2%, as expected in autumn. Economic activity faced weaker external demand, higher interest rates in the euro area and continued price pressures. Nevertheless, private consumption expanded, especially in the first half of 2023, supported by a strong labour market, improved consumer confidence, the decline in inflation and strong lending activity. Exports of goods contracted sizeably, weighing on the volume of industrial production and sales. Faced with lower external demand, firms cut on purchases from abroad and invested considerably less in inventories. Investment also remained subdued in the first half of the year. At the same time, firms were able to largely keep high employment levels and increase nominal wages, albeit more moderately.

Graph 2.21: **Bulgaria - Real GDP growth and contributions**



Real GDP is expected to grow by 1.9% in 2024 and by 2.5% in 2025, broadly unchanged compared to the Autumn 2023 Forecast. Domestic demand is now expected to be the main growth driver. Although exports are set to rebound already in 2024, a negative carry-over effect from 2023 is weighing on the annual growth projection. Household consumption is expected to continue to grow, albeit somewhat less strongly compared to 2023, as the potential for further employment gains appears exhausted and saving rates gradually return to higher levels. These dynamics depend crucially on the expected good labour market performance and the assumption that the pass-through of relatively high foreign interest rates to the domestic credit market remains incomplete. The projected normalisation in the level of inventory accumulation is set to support domestic demand and contribute to the rebound in imports. Investment is also expected to recover, mostly driven by higher absorption of EU funds, including in the context of the implementation of Bulgaria's Recovery and Resilience Plan.

Annual HICP inflation decelerated from 14.3% in December 2022 to 5% in December 2023. Overall, it posted 8.6% in 2023, slightly lower than projected in the 2023 Autumn Forecast. All components contributed to the disinflationary process, with food prices contributing the most. The deceleration of inflation in services was driven mostly by transport and catering services, whose prices largely depend on energy and food prices. The disinflation in food and energy prices also helped to anchor inflation expectations, avoiding to a large extent a wage-price spiral.

Annual HICP inflation is expected to decelerate markedly to 3.4% in 2024, revised down since autumn, and 2.9% in 2025, unchanged compared to the Autumn Forecast. Import prices are set to exert downward pressure on the energy, food and non-energy industrial goods components in 2024. Services price inflation is also projected to decelerate, driven by second-round effects from input prices and a projected moderation in wages.

2.22. CZECHIA

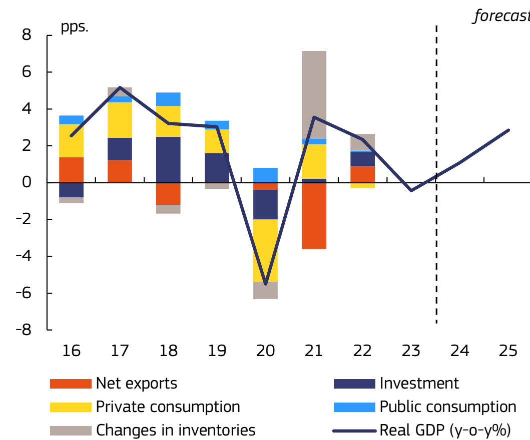
Real GDP is estimated to have contracted by 0.4% in 2023 as expected in the Autumn Forecast, according to the preliminary GDP release. In the fourth quarter of 2023, economic activity grew by 0.2% q-o-q. Private consumption was the main drag on GDP growth, as high inflation eroded consumer confidence and real purchasing power. Net exports are likely to have contributed positively to GDP growth as depressed imports are estimated to have offset a still sluggish exports growth. Despite tight financing conditions, investment

continued growing, benefiting from increasing public investments supported by EU funds and investments in equipment, while conversely residential construction activity remained depressed.

GDP growth is expected to recover gradually to 1.1% in 2024 and 2.8% in 2025, which is below the autumn projections. Economic growth is set to be supported by the high saving rate of households over the past three years, the projected easing of inflation and rising real wages as well as by further relaxation of financing conditions. However, recent consumer and business confidence indicators are still below historical average, indicating an only gradual return to a higher growth rate of private demand.

The recovery of domestic demand, the easing of financing conditions and an acceleration of RRF implementation should support a pick-up in investment growth towards the end of 2024 and in 2025. Conversely, net exports are likely to contribute less than in 2022 and 2023 to GDP growth over the forecast horizon as the recovery in external demand (especially the automotive industry) is set to be slower than the growth of imports driven by internal demand. The relatively high degree of trade openness and energy intensity of the Czech economy continue to imply downside risks in a potential scenario of disruption of global commodities or energy supply chains.

Graph 2.22: **Czechia- Real GDP growth and contributions**

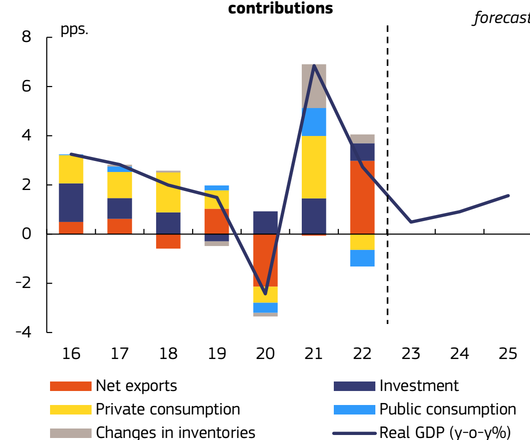


While HICP inflation remained high through-out 2023 (12% for the year and 8.4% in the last quarter), this was due to the high carry-over of inflation from 2023-Q1. Inflation is set to decline sharply in January 2024 and is forecast at 2.9% in 2024 and at 2.3% in 2025 as the increase in energy and food prices is likely to decelerate. This is a downwards revision for both years compared to autumn. The indices of food prices have declined in the second half of 2023 and are unlikely to contribute to inflation in 2024. Real wages are set to grow this year adding some pressure on inflation. This is, however, projected to be offset by broadly stable energy and food prices and by a decline in companies' profit margins. While the expiry of energy support measures and the repricing of the regulated part of the electricity and gas tariffs are set to add pressures to energy inflation in 2024-Q1, this is expected to be partly offset by the decline in wholesale energy prices.

2.23. DENMARK

For the Danish economy 2023 was marked by subdued domestic demand while strong net exports supported real GDP growth. Higher interest rates weighed on investment and private consumption was impacted by real wage losses experienced over recent years. By contrast, exports benefited from strong international demand, notably for pharmaceutical products. A normalisation of the high levels of inventories accumulated during the COVID-19 pandemic prompted a sizeable negative growth contribution from stocks last year. Real GDP is estimated to have grown by 0.5% in 2023, a significant downward revision from the Autumn Forecast, mainly on the back of data revisions for the second and third quarter.

Graph 2.23: **Denmark - Real GDP growth and contributions**



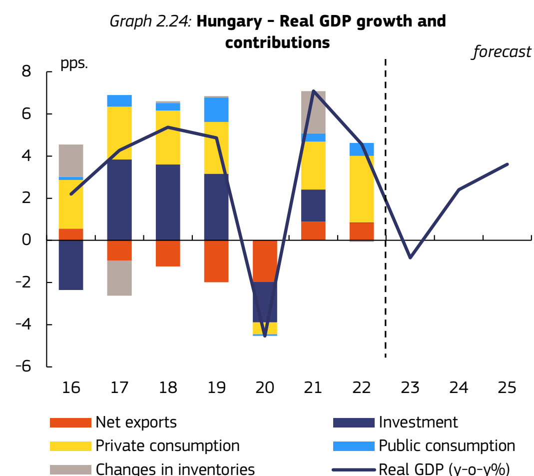
Economic activity is expected to gain some traction over the forecast horizon, driven by domestic demand. Private consumption is set to gradually strengthen throughout 2024, helped by rising real wages as inflation recedes while 2023 collective wage bargaining

outcomes and continued tight labour markets support notable wage increases. Government consumption, including military expenditure, should further contribute to domestic demand growth. Gross fixed capital formation is projected to rebound and then start strengthening during 2024 and into 2025 as interest rates are set to decline. Investments are expected in production and distribution capacity, notably in energy production and infrastructure as well as within the pharmaceutical industry. As a result, real GDP is forecast to expand by 0.9% and 1.6% in 2024 and 2025, respectively. For 2024, this is a downward revision while the forecast for 2025 remains unchanged.

HICP inflation receded over the past year. Annual inflation fell from 8.5% in 2022 to 3.4% in 2023 on the back of weakening energy prices and stabilising food prices. Amid the continued fall in international energy prices, annual inflation is projected to further ease to 1.7% in 2024 before increasing to 2.2% in 2025. This increase is mainly due to base effects, as, in fact, inflation is set to fall to 1.4% in the last quarter of 2025. Compared to autumn, the forecast has been revised down for 2024, but up for 2025. While inflation for several categories of goods is expected to be limited, services are set to hold up inflation somewhat, reflecting continued wage growth.

2.24. HUNGARY

Graph 2.24: **Hungary - Real GDP growth and contributions**



Hungary's economy is projected to have contracted by 0.8% in 2023, broadly as expected in the Autumn Forecast. It expanded by 0.9% q-o-q in the third quarter of 2023 due to the recovery of agricultural output from the severe droughts in 2022. However, monthly indicators point to continuing weakness in industry and construction in 2023-Q4. The contraction in annual GDP was due to falling investment and household consumption. While exports are also estimated to have shrunk in 2023, the larger contraction of import demand resulted in a positive contribution of net exports to GDP growth.

The economy is set to recover gradually in 2024-25, with GDP growth picking up to 2.4% in 2024 and 3.6% in 2025, same as expected in autumn, supported by decreasing inflation and interest rates over the forecast horizon. Household income has received a substantial boost from the 15% minimum wage hike in December 2023, and employment has also held up, with the unemployment rate at 4.2% in December. Real income growth and improving consumer confidence are projected to spur household consumption. The central bank has already begun to reduce interest rates in response to falling inflation. This is expected to contribute to the gradual recovery of investment. New FDI projects are set to boost exports over the forecast horizon. Hungary's economic outlook remains sensitive to global investor sentiment. The country is also particularly exposed to energy price changes and potential supply disruptions due to its large dependence on energy imports and its limited scope for import diversification in the short term.

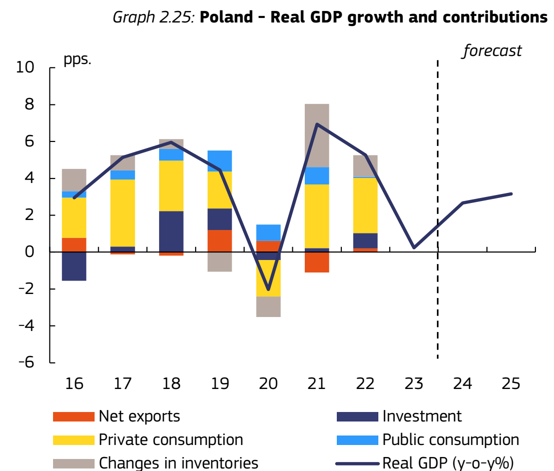
HICP inflation decreased to 5.5% in December 2023 due to base effects, decreasing energy prices, and the domestic recession. Disinflation is expected to proceed at a slower pace over the forecast horizon, due to the recovery of consumption demand and high labour cost growth. The increase of excise duties has also elevated fuel prices in January 2024. Annual HICP is projected to decrease from 17.0% in 2023 to 4.5% in 2024 and 4.1% in 2025. Compared to autumn, the forecast has been revised down for 2024, but remains unchanged for 2025.

2.25. POLAND

The Polish economy grew by 0.2% in 2023, slightly less than projected in the Autumn Forecast. Net exports contributed positively to growth as imports fell more than exports. Investment accelerated amid culmination of EU funding from the 2014-20 programming period. Private consumption contracted and the change in inventories had a large negative contribution to growth.

Economic growth is set to accelerate to 2.7% in 2024. Private consumption is expected to be the main growth driver, supported by rising real wages, additional government social support, and receding inflationary pressures. Public consumption is also set to contribute robustly to growth on the back of new additional fiscal support measures. However, net exports are projected to contribute negatively, as rising domestic demand is expected to fuel imports. Investment is set to be held back by a slower start of EU funds flows from the 2021-27 programming period. In 2025, GDP growth is projected to pick up to 3.2% due to strong private consumption and an uptick in investment fuelled by EU funds. Risks to the outlook relate mainly to possible delays in the implementation of EU-funded investment. The forecast for both years is unrevised compared to autumn.

Graph 2.25: **Poland - Real GDP growth and contributions**

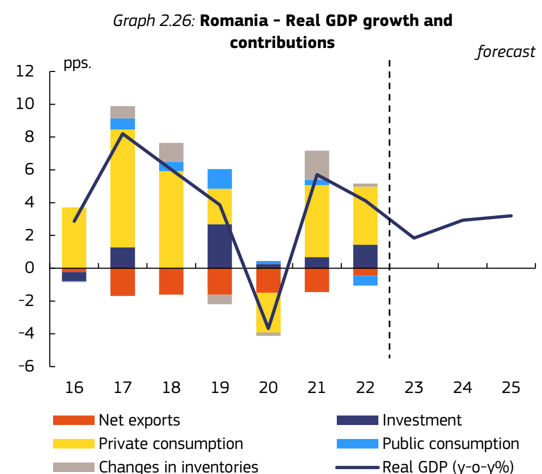


Inflation peaked in early 2023 and eased rapidly in the second half of the year due to decelerating commodity and food prices. HICP inflation reached 10.9% in 2023 and is set to moderate over the forecast horizon. Lower energy commodity price assumptions are set to further curb inflation over the course of 2024 and 2025. HICP inflation is projected at 5.2% in 2024 and 4.7% in 2025. Compared to autumn, the forecast has been revised down for 2024, but up for 2025. In addition to lower commodity prices, these revisions are driven by the extension of the electricity and gas price freezes from January until June, and the zero VAT on food until March this year. The shift in base effects implied by this change reduces the inflation forecast in the first half of 2024, but lifts it in 2025, compared to the Autumn Forecast.

2.26. ROMANIA

Economic growth is estimated to have decelerated to 1.8% in 2023, a 0.4 pps. downward revision from the Autumn Forecast. High inflation and anaemic private credit growth constrained domestic demand in 2023, while external demand was weak. A strong increase in gross fixed capital formation spurred by EU-funded investment in public infrastructure compensated for the slowdown in private consumption and lower inventories, while the negative contribution of net exports to growth subsided. A resilient labour market and two hikes of minimum wages cushioned the deceleration of real disposable incomes. After a weak third quarter, short-term indicators suggest that the economy regained some momentum in the last months of 2023, on the back of retail sales, services and robust construction.

Graph 2.26: **Romania - Real GDP growth and contributions**



This pick-up and slight improvements in some outlook sentiment indicators bode well for economic activity in 2024. Backed by prospects for stronger private credit growth and continued increases in real disposable

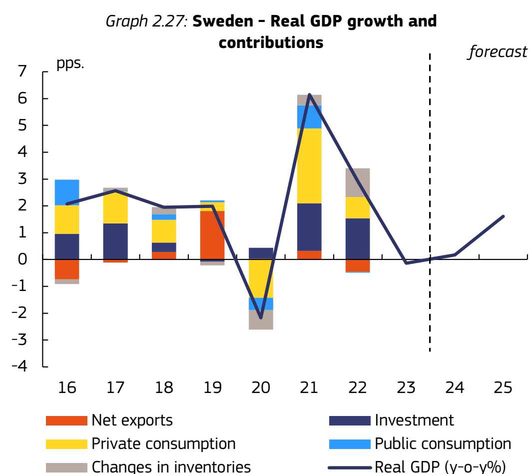
incomes, real GDP is set to grow by 2.9% in 2024, slightly less than expected in autumn. While private consumption is expected to accelerate, investment will remain the main contributor to GDP growth also this year. Monetary policy is set to remain tight in 2024 and only relax gradually, as inflationary pressures abate. This easing of monetary and financial conditions, accompanied by stronger external demand, are set to lead to real GDP growth of 3.2% in 2025, also slightly below the Autumn 2023 Forecast.

HICP inflation decelerated to 7% in December of last year, bringing overall inflation in 2023 down to 9.7% from 12% in 2022. The easing of inflation can be attributed to a significant slowdown in private credit growth amid tight monetary conditions, and to lower energy and food prices. Inflation excluding energy and food declined less and remained above headline inflation at the end of 2023, with strong price growth in services and non-food prices. Except for a brief pause at the beginning of 2024 following some increases in indirect taxes, prices are set to decelerate further over the forecast horizon. Average annual HICP inflation is projected at 5.8% in 2024 before slowing down to 3.6% in 2025, broadly unchanged from autumn. Risks are, however, tilted towards a more gradual disinflationary process if salaries and pensions continue to increase fast.

2.27. SWEDEN

In 2023, the Swedish economy is estimated to have contracted by 0.1%, mainly due to lower private consumption and housing construction. Nominal wage growth below inflation, coupled with high household indebtedness and increased interest rate expenses, eroded real disposable incomes. A sharp drop in housing investment also contributed to the contraction in domestic demand. Exports, especially of services, supported the economy, reflecting strong competitiveness.

Graph 2.27: **Sweden - Real GDP growth and contributions**



Economic growth is projected to remain sluggish at the beginning of 2024 and to pick up in the second half of the year. This is set to be primarily driven by an assumed bottoming out of household consumption, as the combination of falling inflation and lower interest rates supports households' purchasing power. The drag from gross fixed capital formation is expected to fade out as the decline in housing construction moderates, while business investment is set to remain resilient. Net exports are expected to moderate, reflecting the recovery in domestic demand. Overall, real GDP growth is projected to reach a modest 0.2% in 2024, revised up from the Autumn Forecast.

Moderate inflation, good corporate margins, and a relatively resilient labour market are projected to support economic growth in 2025. Falling interest rates should support investment. However, the strength of the upswing in the economy is set to be limited by weak residential construction and the gradual adjustment of household balance sheets and spending to changes in financial conditions. All in all, real GDP growth is forecast to reach 1.6% in 2025, revised up compared to autumn.

HICP inflation fell rapidly during 2023 as base effects and the easing of supply bottlenecks outweighed the lagged pass-through of the weaker effective exchange rate. Energy prices for households and corporates are expected to decline sharply in the first part of 2024, mirroring lower global energy prices, changes in energy taxation and lower requirements for the blending of biofuels in petrol and diesel. Domestic wage and price pressures are set to remain contained over the forecast horizon. Inflation excluding energy, however, is set to recede relatively slowly in view of persistent price increases for certain services such as for hotels and restaurants. With fairly anchored inflation expectations and the cyclical weakness in demand, consumer price increases are expected to remain limited. Overall, HICP inflation is forecast at 1.7% in 2024, broadly unchanged from autumn. Inflation is set to reach 1.9 % in 2025, less than expected in the Autumn Forecast.

STATISTICAL ANNEX

Table 1: Gross domestic product, volume (percentage change on preceding year, 2005-2025) 01.02.2024

	5-year averages							Winter 2024 interim forecast			Autumn 2023 forecast		
	2005 - 09	2010 - 14	2015 - 19	2019	2020	2021	2022	2023	2024	2025	*2023*	*2024*	*2025*
Belgium	1.4	1.5	1.8	2.2	-5.3	6.9	3.0	**1.5**	**1.4**	**1.5**	*1.4*	*1.4*	*1.5*
Germany	0.5	2.2	1.7	1.1	-3.8	3.2	1.8	**-0.3**	**0.3**	**1.2**	*-0.3*	*0.8*	*1.2*
Estonia	0.9	3.5	3.7	4.0	-1.0	7.2	-0.5	**-3.5**	**0.6**	**3.2**	*-2.6*	*1.9*	*2.7*
Ireland	1.2	2.5	9.6	5.3	6.6	15.1	9.4	**-1.9**	**1.2**	**3.2**	*-0.9*	*3.0*	*3.4*
Greece	0.9	-5.0	0.8	1.9	-9.3	8.4	5.6	**2.2**	**2.3**	**2.3**	*2.4*	*2.3*	*2.2*
Spain	1.7	-0.7	2.8	2.0	-11.2	6.4	5.8	**2.5**	**1.7**	**2.0**	*2.4*	*1.7*	*2.0*
France	0.8	1.2	1.6	1.8	-7.5	6.4	2.5	**0.9**	**0.9**	**1.3**	*1.0*	*1.2*	*1.4*
Croatia	1.7	-0.9	3.1	3.4	-8.6	13.8	6.3	**2.6**	**2.6**	**2.8**	*2.6*	*2.5*	*2.8*
Italy	-0.5	-0.5	1.0	0.5	-9.0	8.3	3.7	**0.6**	**0.7**	**1.2**	*0.7*	*0.9*	*1.2*
Cyprus	3.2	-1.9	5.4	5.5	-3.4	9.9	5.1	**2.4**	**2.8**	**3.0**	*2.2*	*2.6*	*2.9*
Latvia	2.5	1.7	2.8	0.6	-3.5	6.7	3.4	**-0.6**	**1.7**	**2.7**	*-0.2*	*2.4*	*3.0*
Lithuania	2.4	3.7	3.5	4.7	0.0	6.3	2.4	**-0.3**	**2.1**	**3.0**	*-0.4*	*2.5*	*3.4*
Luxembourg	2.5	2.4	2.5	2.9	-0.9	7.2	1.4	**-0.8**	**1.3**	**2.1**	*-0.6*	*1.4*	*2.0*
Malta	2.7	4.6	7.6	7.1	-8.1	12.6	8.2	**6.1**	**4.6**	**4.3**	*4.0*	*4.0*	*4.2*
Netherlands	1.5	0.6	2.3	2.0	-3.9	6.2	4.3	**0.2**	**0.4**	**1.6**	*0.6*	*1.1*	*1.7*
Austria	1.4	1.2	1.8	1.5	-6.6	4.2	4.8	**-0.7**	**0.6**	**1.4**	*-0.5*	*1.0*	*1.3*
Portugal	0.4	-0.8	2.6	2.7	-8.3	5.7	6.8	**2.3**	**1.2**	**1.8**	*2.2*	*1.3*	*1.8*
Slovenia	2.4	0.2	3.6	3.5	-4.2	8.2	2.5	**1.3**	**1.9**	**2.7**	*1.3*	*2.0*	*2.7*
Slovakia	5.1	2.8	3.3	2.5	-3.3	4.8	1.8	**1.1**	**2.3**	**2.6**	*1.3*	*1.7*	*2.0*
Finland	0.8	0.6	1.8	1.2	-2.4	2.8	1.6	**-0.4**	**0.6**	**1.6**	*0.1*	*0.8*	*1.5*
Euro area (20)	0.7	0.8	2.0	1.6	-6.1	5.9	3.4	**0.5**	**0.8**	**1.5**	*0.6*	*1.2*	*1.6*
Bulgaria	4.6	1.0	3.2	4.0	-4.0	7.7	3.9	**2.0**	**1.9**	**2.5**	*2.0*	*1.8*	*2.6*
Czechia	3.3	1.1	3.9	3.0	-5.5	3.6	2.4	**-0.4**	**1.1**	**2.8**	*-0.4*	*1.4*	*3.0*
Denmark	0.3	1.2	2.4	1.5	-2.4	6.8	2.7	**0.5**	**0.9**	**1.6**	*1.2*	*1.4*	*1.6*
Hungary	0.5	1.5	4.1	4.9	-4.5	7.1	4.6	**-0.8**	**2.4**	**3.6**	*-0.7*	*2.4*	*3.6*
Poland	4.7	2.8	4.6	4.5	-2.0	6.9	5.3	**0.2**	**2.7**	**3.2**	*0.4*	*2.7*	*3.2*
Romania	4.6	1.3	4.8	3.9	-3.7	5.7	4.1	**1.8**	**2.9**	**3.2**	*2.2*	*3.1*	*3.4*
Sweden	1.2	2.5	2.6	2.0	-2.2	6.1	2.9	**-0.1**	**0.2**	**1.6**	*-0.5*	*-0.2*	*1.3*
EU	0.9	1.0	2.2	1.8	-5.6	6.0	3.4	**0.5**	**0.9**	**1.7**	*0.6*	*1.3*	*1.7*

Table 2: Profiles (qoq) of quarterly GDP, volume (percentage change from previous quarter) 01.02.2024

	2023/1	2023/2	2023/3	2023/4	2024/1	2024/2	2024/3	2024/4	2025/1	2025/2	2025/3	2025/4
Belgium	0.4	0.3	0.4	0.4	0.4	0.4	0.3	0.3	0.4	0.4	0.4	0.2
Germany	0.1	0.0	0.0	-0.3	0.1	0.2	0.3	0.3	0.3	0.4	0.4	0.4
Estonia	-0.8	-0.6	-1.3	0.0	0.2	0.5	1.1	1.1	0.8	0.7	0.6	0.6
Ireland	-1.9	-0.4	-1.9	-0.7	:	:	:	:	:	:	:	:
Greece	0.1	1.1	0.0	:	:	:	:	:	:	:	:	:
Spain	0.5	0.5	0.4	0.6	0.3	0.4	0.5	0.5	0.4	0.5	0.6	0.5
France	0.0	0.7	0.0	0.0	0.2	0.2	0.4	0.4	0.4	0.3	0.3	0.2
Croatia	0.9	1.5	0.3	0.9	0.6	0.6	0.5	0.7	0.7	0.8	0.8	0.7
Italy	0.6	-0.3	0.1	0.2	0.1	0.2	0.3	0.3	0.3	0.4	0.4	0.3
Cyprus	1.0	-0.4	1.1	:	:	:	:	:	:	:	:	:
Latvia	-0.5	-0.3	0.2	0.4	0.5	0.6	0.7	0.7	0.7	0.6	0.6	0.7
Lithuania	-1.9	2.4	0.0	-0.3	0.6	0.6	0.7	0.7	0.7	0.8	0.8	0.8
Luxembourg	0.9	-0.2	-0.1	0.1	0.6	0.7	0.7	0.7	0.5	0.4	0.4	0.3
Malta	0.5	1.9	2.4	:	:	:	:	:	:	:	:	:
Netherlands	-0.5	-0.4	-0.3	0.1	0.2	0.3	0.3	0.4	0.4	0.4	0.4	0.4
Austria	0.1	-1.1	-0.5	0.2	0.3	0.4	0.5	0.5	0.3	0.3	0.2	0.2
Portugal	1.5	0.1	-0.2	0.8	0.3	0.3	0.4	0.4	0.4	0.5	0.5	0.5
Slovenia	0.2	1.0	-0.2	-0.1	0.5	0.7	0.8	0.7	0.6	0.6	0.6	0.5
Slovakia	0.2	0.4	0.2	0.5	0.6	0.7	0.7	0.7	0.7	0.6	0.5	0.5
Finland	0.0	0.3	-0.9	-0.1	0.1	0.3	0.5	0.5	0.5	0.5	0.4	0.4
Euro area (20)	0.1	0.1	-0.1	0.0	0.2	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Bulgaria	0.3	0.4	0.4	0.5	0.5	0.6	0.3	0.3	0.9	0.7	0.7	0.7
Czechia	0.1	0.1	-0.6	0.2	0.3	0.4	0.6	0.7	0.7	0.7	0.7	0.7
Denmark	0.9	-0.7	-0.7	0.5	0.2	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Hungary	-0.2	0.0	0.9	-0.3	0.7	0.8	1.0	1.0	0.9	0.8	0.8	0.8
Poland	1.1	0.3	1.5	:	:	:	:	:	:	:	:	:
Romania	-0.8	1.5	0.9	:	:	:	:	:	:	:	:	:
Sweden	0.7	-0.6	-0.1	0.1	-0.1	0.1	0.4	0.4	0.4	0.4	0.4	0.4
EU	0.1	0.1	-0.1	0.0	0.2	0.3	0.4	0.4	0.4	0.4	0.4	0.4

Table 3: Harmonised index of consumer prices, (percentage change on preceding year, 2005-2025) 01.02.2024

	5-year averages							Winter 2024 interim forecast			Autumn 2023 forecast		
	2005 - 09	2010 - 14	2015 - 19	2019	2020	2021	2022	2023	2024	2025	2023	2024	2025
Belgium	2.2	2.0	1.6	1.2	0.4	3.2	10.3	2.3	3.5	2.3	2.4	4.2	1.9
Germany	1.8	1.6	1.2	1.4	0.4	3.2	8.7	6.0	2.8	2.4	6.2	3.1	2.2
Estonia	5.2	3.1	2.0	2.3	-0.6	4.5	19.4	9.1	3.2	1.9	9.4	3.5	2.1
Ireland	1.8	0.5	0.3	0.9	-0.5	2.4	8.1	5.2	2.2	1.9	5.3	2.7	2.1
Greece	3.1	1.3	0.3	0.5	-1.3	0.6	9.3	4.2	2.7	2.0	4.3	2.8	2.1
Spain	2.7	1.8	0.7	0.8	-0.3	3.0	8.3	3.4	3.2	2.1	3.6	3.4	2.1
France	1.7	1.6	1.0	1.3	0.5	2.1	5.9	5.7	2.8	2.0	5.8	3.0	2.0
Croatia	3.4	1.8	0.5	0.8	0.0	2.7	10.7	8.4	2.5	2.0	8.1	2.4	1.6
Italy	2.1	1.9	0.7	0.6	-0.1	1.9	8.7	5.9	2.0	2.3	6.1	2.7	2.3
Cyprus	2.2	1.8	-0.2	0.5	-1.1	2.3	8.1	3.9	2.4	2.1	4.1	3.0	2.2
Latvia	8.3	1.2	1.7	2.7	0.1	3.2	17.2	9.1	2.2	2.2	9.6	3.2	1.9
Lithuania	5.5	2.0	1.7	2.2	1.1	4.6	18.9	8.7	2.4	2.4	8.8	2.9	2.5
Luxembourg	2.7	2.4	1.2	1.6	0.0	3.5	8.2	2.9	2.6	2.3	3.2	3.0	1.8
Malta	2.5	1.9	1.3	1.5	0.8	0.7	6.1	5.6	2.9	2.7	5.7	3.3	3.1
Netherlands	1.6	1.8	1.2	2.7	1.1	2.8	11.6	4.1	2.6	2.0	4.6	3.7	2.0
Austria	1.9	2.3	1.5	1.5	1.4	2.8	8.6	7.7	4.0	3.0	7.7	4.1	3.0
Portugal	1.9	1.6	0.8	0.3	-0.1	0.9	8.1	5.3	2.3	1.9	5.5	3.2	2.4
Slovenia	3.0	1.8	0.8	1.7	-0.3	2.0	9.3	7.2	2.9	2.0	7.5	3.9	2.4
Slovakia	2.8	2.0	1.2	2.8	2.0	2.8	12.1	11.0	3.5	2.6	10.8	5.2	3.0
Finland	1.8	2.3	0.7	1.1	0.4	2.1	7.2	4.3	1.4	1.5	4.4	1.9	2.0
Euro area (20)	2.0	1.7	1.0	1.2	0.3	2.6	8.4	5.4	2.7	2.2	5.6	3.2	2.2
Bulgaria	7.0	1.5	0.8	2.5	1.2	2.8	13.0	8.6	3.4	2.9	8.8	4.0	2.9
Czechia	2.7	1.7	1.6	2.6	3.3	3.3	14.8	12.0	2.9	2.3	12.2	3.2	2.4
Denmark	2.0	1.6	0.5	0.7	0.3	1.9	8.5	3.4	1.7	2.2	3.6	2.4	2.1
Hungary	5.1	3.2	1.8	3.4	3.4	5.2	15.3	17.0	4.5	4.1	17.2	5.2	4.1
Poland	2.8	2.2	0.8	2.1	3.7	5.2	13.2	10.9	5.2	4.7	11.1	6.2	3.8
Romania	6.8	4.0	1.5	3.9	2.3	4.1	12.0	9.7	5.8	3.6	9.8	5.9	3.4
Sweden	1.9	1.0	1.5	1.7	0.7	2.7	8.1	5.9	1.7	1.9	5.7	1.8	2.2
EU	2.3	1.8	1.0	1.4	0.7	2.9	9.2	6.3	3.0	2.5	6.5	3.5	2.4

Table 4: Harmonised index of consumer prices, (percentage change on preceding year) 01.02.2024

	2023/1	2023/2	2023/3	2023/4	2024/1	2024/2	2024/3	2024/4	2025/1	2025/2	2025/3	2025/4
Belgium	5.9	2.6	1.6	-0.6	2.5	4.5	3.7	3.3	2.7	2.3	2.1	1.9
Germany	8.7	6.9	5.7	3.0	3.0	2.7	2.6	3.0	2.6	2.4	2.4	2.2
Estonia	17.3	11.1	4.8	4.5	4.9	3.2	2.8	2.1	2.2	2.1	1.8	1.6
Ireland	7.5	5.5	4.8	3.1	2.7	2.2	2.0	2.1	2.1	2.0	1.8	1.8
Greece	6.4	3.8	3.1	3.5	3.5	2.8	2.3	2.1	1.9	2.0	2.0	2.0
Spain	5.0	2.8	2.6	3.3	3.4	3.2	3.2	3.0	2.6	2.2	1.9	1.7
France	7.0	6.1	5.5	4.2	3.3	2.8	2.6	2.3	2.2	2.1	2.0	1.9
Croatia	11.6	8.5	8.0	5.9	4.3	2.6	1.2	2.0	2.0	2.2	1.9	1.7
Italy	9.5	7.8	5.8	1.0	1.3	2.1	2.3	2.5	2.4	2.1	2.3	2.3
Cyprus	6.5	3.4	3.3	2.6	2.7	2.7	2.3	2.1	2.4	2.1	1.9	1.9
Latvia	19.5	11.7	5.3	1.4	2.0	2.3	2.2	2.4	2.1	2.0	2.2	2.6
Lithuania	17.0	10.7	5.9	2.3	2.2	2.5	2.5	2.4	2.4	2.3	2.4	2.4
Luxembourg	4.5	1.9	3.0	2.4	3.0	2.8	2.3	2.2	2.4	2.3	2.3	2.2
Malta	7.0	6.3	5.2	3.9	3.1	2.7	2.8	2.8	2.9	2.7	2.6	2.5
Netherlands	7.2	6.3	2.8	0.4	3.1	2.6	2.4	2.3	2.2	1.9	1.9	1.9
Austria	10.6	8.6	6.7	5.1	4.5	4.2	4.2	3.2	3.0	3.1	3.0	3.0
Portugal	8.4	5.7	4.8	2.4	2.6	2.6	2.0	2.0	2.0	2.0	1.9	1.9
Slovenia	9.9	7.9	6.3	5.0	3.5	3.0	2.8	2.4	2.4	1.8	1.8	1.8
Slovakia	15.1	12.5	9.6	7.1	4.8	3.3	3.2	2.9	2.7	2.6	2.5	2.4
Finland	7.5	5.1	3.4	1.5	1.5	1.2	1.2	1.5	1.5	1.4	1.4	1.4
Euro area (20)	8.0	6.2	5.0	2.7	2.9	2.8	2.7	2.7	2.4	2.2	2.2	2.1
Bulgaria	13.4	8.8	7.2	5.5	3.9	3.5	3.0	3.1	3.1	2.9	2.9	2.8
Czechia	18.0	12.6	9.5	8.4	2.8	2.9	2.6	3.5	2.6	2.4	2.1	2.2
Denmark	8.0	3.6	2.0	0.1	0.4	2.2	1.6	2.6	2.7	2.3	1.9	1.6
Hungary	25.9	22.1	14.6	7.6	4.2	4.6	4.2	4.9	4.6	4.0	3.8	3.9
Poland	16.1	12.5	9.2	6.3	4.3	4.1	6.4	6.2	5.9	5.3	3.7	3.8
Romania	13.0	9.8	9.1	7.4	7.0	6.1	5.3	4.7	4.0	3.7	3.4	3.3
Sweden	9.1	6.9	4.8	3.0	1.7	1.3	1.6	2.1	2.0	2.0	1.8	1.8
EU	9.4	7.2	5.7	3.4	3.0	2.9	2.9	2.9	2.6	2.4	2.3	2.2

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Box .1: **Some technical elements behind the forecast**

The Winter 2024 interim Forecast provides an update of the Autumn 2023 Forecast of 15 November 2023, focusing on GDP and inflation developments in all EU Member States.

The cut-off date for taking new information into account in this forecast was 1 February 2024.

ESA 2010

The source for all tables is the European Commission, unless otherwise stated. Historical data for the Member States are based on the European System of Accounts (ESA 2010). Due to differences in revision schedules of annual and quarterly national accounts, annual and quarterly figures may not be fully consistent for some Member States. 2024 and 2025 are forecast years. 2023 GDP data are also forecast, except for AT, BE, CZ, DE, FR, IE, IT, EE, ES, LV, LT, PL, PT and SE where preliminary or flash estimates exist.

HICP inflation

This forecast takes into account preliminary HICP item weights for AT, BE, CY, FI, FR, HR, IE, IT, ES, LV, LT, LU, PT, SI and SK that were published by Eurostat on 1 February.

Working-day adjustment

The number of working days may differ from one year to another. The Commission's annual GDP forecasts are not adjusted for the number of working days, but quarterly forecasts are. The working-day effect in the EU and the euro area is estimated to be limited over the forecast horizon, implying that adjusted and unadjusted annual growth rates differ only marginally, but it may be significant in the case of some Member States. However, for 2024 and 2025, these rates differ by little more than 0.1 pps., reflecting also the fact that for some Member States no quarterly forecasts are produced.

Technical assumptions

To shield the assumptions from possible volatility during any given trading day, averages from a 10-day reference period (between 16 and 29 January) were used for exchange and interest rates, and for commodity prices.

Assumptions for Brent oil, natural gas and electricity prices are based on futures markets.

Nominal exchange rates are kept constant over the forecast horizon at the level recorded during the reference period (see Table 1).

Table 1:

	Winter 2024 interim Forecast			*Autumn 2023 Forecast*		
	2023	2024	2025	2023	2024	2025
3-month EURIBOR (percentage per annum)	3.4	**3.2**	**2.2**	*3.4*	*3.7*	*3.1*
10-year government bond yields (percentage per annum) (a)	2.4	**2.3**	**2.3**	*2.5*	*2.8*	*2.8*
USD/EUR exchange rate	1.08	**1.09**	**1.09**	*1.08*	*1.06*	*1.06*
GBP/EUR exchange rate	0.87	**0.86**	**0.86**	*0.87*	*0.87*	*0.87*
RMB/EUR exchange rate	7.66	**7.81**	**7.81**	*7.65*	*7.73*	*7.73*
JPY/EUR exchange rate	151.99	**160.53**	**160.62**	*151.81*	*158.32*	*158.32*
EUR nominal effective exchange rate (annual percentage change) (b)	5.8	**1.5**	**0.0**	5.6	1.0	0.0
Natural gas (EUR/Mwh) (c)	41.4	**29.8**	**32.3**	*43.3*	*55.1*	*47.7*
Electricity (EUR/Mwh) (d)	102.2	**74.7**	**79.9**	106.0	133.5	121.7
Oil price (USD per barrel)	82.5	**78.5**	**74.7**	*84.1*	*84.5*	*79.6*

(a) 10-year government bond yields for the euro area equal the German government bond yields.
(b) 42 industrial countries EU TR CH NR UK US CA JP AU MX NZ KO CN HK RU BR. (c) ICE Dutch TTF. (d) GDP - weighted average of electricity prices in DE, FR, IT, ES, NL, BE, AT.

(Continued on the next page)

Box (continued)

Starting with this forecast round, all interest rate assumptions are derived directly from implicit market rates thus fully reflecting market expectations at the time of the forecast ([1]). The assumptions for short-term interest rates are the same for all the euro area Member States and are derived from the average level recorded during the reference period of three-month EURIBOR futures contracts over the forecast horizon. In the absence of future contracts that are consistent across countries, the assumptions for short-term rates of the other EU Member States and countries outside EU are derived from the average level over the reference period of the implicit forward three-month OIS (overnight indexed swap) rates, corrected for the average spread over the reference period between the benchmark short-term interest rate and the OIS swap rate with a similar maturity (i.e. three-month). The assumptions for long-term interest rates for the euro area Member States are derived directly from the average level over the reference period of the forwards of euro area sovereign rates when available. Forward sovereign rates are also used, when available, to derive assumptions for long-term interest rates of the other EU Member States as well as of the countries outside EU examined in the forecast ([2]).

Trade policies

For trade policy, this forecast pencils in only the measures that have been implemented until the cut-off date. Compared to the Autumn 2023 Forecast, there are no significant changes.

Geographical zones

Euro area: EA20 (BE, DE, EE, IE, EL, ES, FR, HR, IT, CY, LV, LT, LU, MT, NL, AT, PT, SI, SK and FI).

European Union: EU (EA20, BG, CZ, DK, HU, PL, RO and SE).

([1]) Previously, assumptions for long-term interest rates were derived from euro area spot and forward swap rates, adjusted with a fixed spread between the spot swap rate and the spot sovereign yields with a similar maturity. From this forecast round, the assumptions for long-term interest rates for each country are instead derived directly from country-specific forwards sovereign rates, thus fully reflecting market expectations about each country. This new approach for the calculation of assumptions for long-term interest rates does not lead to significant differences compared to the previous methodology but enhances the consistency between short- and long-term interest rate assumptions and across countries over the forecast horizon.

([2]) When forward sovereign rates are not available, the assumptions can be derived from forward swap rates (i.e. Russia and Iceland), using the average level over the reference period of the implicit forward swap rates corrected in a similar way as the assumptions for short-term interest rates. For countries where no market instrument is available (i.e. forwards), a fixed spread between the monthly average of the country short- or long-term benchmark rates over the latest available month and the monthly average of the euro area benchmark interest rates with a similar maturity over the same month (i.e. the three-month EURIBOR rate for euro area benchmark short-term rate and the 10-year German sovereign rate for the euro area benchmark long-term rate) is added to the relevant interest rate assumptions for the euro area (i.e. the assumptions for euro area short-term rates or the assumptions for long-term German rates).

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