GROWTH MODERATES AMID HIGH UNCERTAINTY

Economic activity in the EU and the euro area moderated last year on the back of a combination of internal and external factors. While a moderation of growth was already in the cards, the slowdown in the second half of 2018 turned out to be more pronounced than expected. Growth in the euro area slipped to 0.2% in the last two quarters of 2018 and the latest high frequency data suggest that this weak momentum continued in January 2019. Over the next two years, the economy is expected to continue growing but at a slower pace. Outside the EU, activity is also slowing down amid high uncertainties, and the outlook varies for different parts of the world.

The slowdown over the course of 2018 reflects fading support from the external environment, as increased uncertainty regarding trade policies, notably between the US and China, and a declining trend in global manufacturing output translated into weaker global trade growth. The euro area appears to be particularly impacted given the geographical orientation of its external trade and its product specialisation. Specific domestic factors also contributed to the loss of growth momentum in the second half of the year. These include the disruption of car production in the third quarter, which has since only partially rebounded, as well as social tensions and fiscal policy uncertainty in some Member States. Despite these developments, the fundamentals of the European economy remain sound. Improving labour market conditions, low financing costs and a slightly expansionary fiscal policy stance this year should allow the expansion to continue, but at a more moderate pace.

Overall, the GDP growth forecast for the euro area in 2019 has been revised down by 0.6 pps. since the autumn forecast to 1.3%. This revision mirrors a weaker carry-over from the last quarters of 2018 and a slightly weaker momentum in 2019. Next year, economic growth is expected to settle at 1.6%, i.e. 0.1 pps. lower compared to the autumn forecast. Euro area headline inflation declined at the end of 2018 on the back of a sharp drop in energy prices. The resulting base effects for this year and lower assumptions about oil prices entail a downward revision of euro area headline inflation to 1.4% in 2019. A very gradual pick-up in inflation is expected in 2020 (1.5%).

The outlook for the EU's economic growth is, however, predicated on receding uncertainties and a gradual unwinding of temporary domestic factors currently holding back domestic growth. Risks remain substantial and mainly stem from potential policy mistakes across the globe. Even if easing somewhat, trade tensions and the uncertainty surrounding their evolution still pose high risks for the global economy. In the US, the risk of an abrupt fiscal tightening appears to have increased, especially for 2020. The Chinese economy might be slowing more sharply than anticipated while many emerging markets are still vulnerable to sudden changes in global risk sentiment. Global financial markets remain exposed to further changes in perceptions of global growth prospects and investor appetite for risk, which would in turn have repercussions on the global economy. In the euro area, the risks of a resumption of negative sovereign-bank loops remain in some Member States. Temporary factors currently holding back growth could turn out to be more lasting than expected. Finally, large uncertainty still surrounds Brexit. On the positive side, a more extensive use of EU funds in recipient countries could trigger additional investments and the still favourable labour market conditions could result in stronger domestic demand.

Table 1:
Overview - the Winter 2019 (interim) forecast

	Real GDP						Inflation					
	Winter 2019 forecast			Autumn 2018 forecast			Winter 2019 forecast			Autumn 2018 forecast		
	2018	2019	2020	2018	2019	2020	2018	2019	2020	2018	2019	2020
Euro area	1.9	**1.3**	**1.6**	*2.1*	***1.9***	***1.7***	1.7	**1.4**	**1.5**	1.8	**1.8**	**1.6**
EU27	2.1	**1.5**	**1.8**	2.2	**2.0**	**1.9**	1.8	**1.6**	**1.7**	1.8	**1.9**	**1.7**
EU28	1.9	**1.5**	**1.7**	*2.1*	***1.9***	***1.8***	1.9	**1.6**	**1.8**	2.0	**2.0**	**1.8**