# OVERVIEW

A cyclical upswing is underway favoured by several temporary tailwinds …

The outlook for economic growth in the EU has brightened. Recent hard and soft indicators confirm that a cyclical upswing driven by private consumption is underway and most data suggest that growth may still strengthen in the near term, as the economy receives an extra boost from tailwind factors such as low oil prices, a weaker euro and quantitative easing (QE) from the European Central Bank. But despite the flattering effect of these positive factors, the pick-up in activity has yet to spread to a broad range of sectors and clouds loom over the horizon. Geopolitical tensions with Russia and high unemployment rates in some Member States continue to weigh on GDP growth.

…whose strength underpins an upward revision to the growth forecast this year …

The combined strength of a number of positive factors blowing in the EU's direction underpin a slight upward revision for GDP growth this year. Real GDP growth in the euro area is now expected to pick up from 0.9 % last year to 1.5% in 2015 and 1.9% in 2016. In the EU, GDP growth is now forecast to rise from 1.4% in 2014 to 1.8% this year and 2.1% in 2016.

One of the main factors working in the EU's favour is the price of oil, which remains exceptionally low, even after having bounced back since the winter.

*Table 1:*

**Overview - the spring 2015 forecast**

| | Real GDP | | | | Inflation | | | | Unemployment rate | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2013 | 2014 | 2015 | 2016 | 2013 | 2014 | 2015 | 2016 | 2013 | 2014 | 2015 | 2016 |
| Belgium | 0.3 | 1.0 | 1.1 | 1.5 | 1.2 | 0.5 | 0.3 | 1.3 | 8.4 | 8.5 | 8.4 | 8.1 |
| Germany | 0.1 | 1.6 | 1.9 | 2.0 | 1.6 | 0.8 | 0.3 | 1.8 | 5.2 | 5.0 | 4.6 | 4.4 |
| Estonia | 1.6 | 2.1 | 2.3 | 2.9 | 3.2 | 0.5 | 0.2 | 1.9 | 8.6 | 7.4 | 6.2 | 5.8 |
| Ireland | 0.2 | 4.8 | 3.6 | 3.5 | 0.5 | 0.3 | 0.4 | 1.5 | 13.1 | 11.3 | 9.6 | 9.2 |
| Greece | -3.9 | 0.8 | 0.5 | 2.9 | -0.9 | -1.4 | -1.5 | 0.8 | 27.5 | 26.5 | 25.6 | 23.2 |
| Spain | -1.2 | 1.4 | 2.8 | 2.6 | 1.5 | -0.2 | -0.6 | 1.1 | 26.1 | 24.5 | 22.4 | 20.5 |
| France | 0.3 | 0.4 | 1.1 | 1.7 | 1.0 | 0.6 | 0.0 | 1.0 | 10.3 | 10.3 | 10.3 | 10.0 |
| Italy | -1.7 | -0.4 | 0.6 | 1.4 | 1.3 | 0.2 | 0.2 | 1.8 | 12.1 | 12.7 | 12.4 | 12.4 |
| Cyprus | -5.4 | -2.3 | -0.5 | 1.4 | 0.4 | -0.3 | -0.8 | 0.9 | 15.9 | 16.1 | 16.2 | 15.2 |
| Latvia | 4.2 | 2.4 | 2.3 | 3.2 | 0.0 | 0.7 | 0.7 | 2.2 | 11.9 | 10.8 | 10.4 | 9.4 |
| Lithuania | 3.3 | 2.9 | 2.8 | 3.3 | 1.2 | 0.2 | -0.4 | 1.7 | 11.8 | 10.7 | 9.9 | 9.1 |
| Luxembourg | 2.0 | 3.1 | 3.4 | 3.5 | 1.7 | 0.7 | 0.8 | 2.1 | 5.9 | 5.9 | 5.7 | 5.4 |
| Malta | 2.7 | 3.5 | 3.6 | 3.2 | 1.0 | 0.8 | 1.3 | 1.9 | 6.4 | 5.9 | 5.9 | 5.9 |
| Netherlands | -0.7 | 0.9 | 1.6 | 1.7 | 2.6 | 0.3 | 0.2 | 1.3 | 7.3 | 7.4 | 7.1 | 6.9 |
| Austria | 0.2 | 0.3 | 0.8 | 1.5 | 2.1 | 1.5 | 0.8 | 1.9 | 5.4 | 5.6 | 5.8 | 5.7 |
| Portugal | -1.6 | 0.9 | 1.6 | 1.8 | 0.4 | -0.2 | 0.2 | 1.3 | 16.4 | 14.1 | 13.4 | 12.6 |
| Slovenia | -1.0 | 2.6 | 2.3 | 2.1 | 1.9 | 0.4 | 0.1 | 1.7 | 10.1 | 9.7 | 9.4 | 9.2 |
| Slovakia | 1.4 | 2.4 | 3.0 | 3.4 | 1.5 | -0.1 | -0.2 | 1.4 | 14.2 | 13.2 | 12.1 | 10.8 |
| Finland | -1.3 | -0.1 | 0.3 | 1.0 | 2.2 | 1.2 | 0.2 | 1.3 | 8.2 | 8.7 | 9.1 | 9.0 |
| **Euro area** | **-0.4** | **0.9** | **1.5** | **1.9** | **1.4** | **0.4** | **0.1** | **1.5** | **12.0** | **11.6** | **11.0** | **10.5** |
| Bulgaria | 1.1 | 1.7 | 1.0 | 1.3 | 0.4 | -1.6 | -0.5 | 1.0 | 13.0 | 11.4 | 10.4 | 9.8 |
| Czech Republic | -0.7 | 2.0 | 2.5 | 2.6 | 1.4 | 0.4 | 0.2 | 1.4 | 7.0 | 6.1 | 5.6 | 5.5 |
| Denmark | -0.5 | 1.1 | 1.8 | 2.1 | 0.5 | 0.3 | 0.6 | 1.7 | 7.0 | 6.6 | 6.2 | 5.9 |
| Croatia | -0.9 | -0.4 | 0.3 | 1.2 | 2.3 | 0.2 | 0.1 | 1.3 | 17.3 | 17.3 | 17.0 | 16.6 |
| Hungary | 1.5 | 3.6 | 2.8 | 2.2 | 1.7 | 0.0 | 0.0 | 2.5 | 10.2 | 7.7 | 6.8 | 6.0 |
| Poland | 1.7 | 3.4 | 3.3 | 3.4 | 0.8 | 0.1 | -0.4 | 1.1 | 10.3 | 9.0 | 8.4 | 7.9 |
| Romania | 3.4 | 2.8 | 2.8 | 3.3 | 3.2 | 1.4 | 0.2 | 0.9 | 7.1 | 6.8 | 6.6 | 6.4 |
| Sweden | 1.3 | 2.1 | 2.5 | 2.8 | 0.4 | 0.2 | 0.7 | 1.6 | 8.0 | 7.9 | 7.7 | 7.6 |
| United Kingdom | 1.7 | 2.8 | 2.6 | 2.4 | 2.6 | 1.5 | 0.4 | 1.6 | 7.6 | 6.1 | 5.4 | 5.3 |
| **EU** | **0.0** | **1.4** | **1.8** | **2.1** | **1.5** | **0.6** | **0.1** | **1.5** | **10.9** | **10.2** | **9.6** | **9.2** |
| USA | **2.2** | **2.4** | **3.1** | **3.0** | 1.5 | 1.6 | 0.4 | 2.2 | 7.4 | 6.2 | 5.4 | 5.0 |
| Japan | **1.6** | **0.0** | **1.1** | **1.4** | 0.4 | 2.7 | 0.5 | 0.9 | 4.0 | 3.6 | 3.6 | 3.5 |
| China | **7.6** | **7.4** | **7.0** | **6.8** | 2.6 | 2.0 | 2.5 | 3.0 | : | : | : | : |
| **World** | **3.3** | **3.4** | **3.5** | **3.9** | : | : | : | : | : | : | : | : |

At the same time, the effective exchange rate of the euro has continued to fall, boosting firms' competitiveness and profit margins.

Financial markets and asset prices are also benefiting by more than expected from the substantial liquidity being created by the ECB's expanded asset purchase programme (APP). The ECB's QE has prevented an increase in real interest rates by re-anchoring inflation expectations. This in turn is likely to make the impact of low oil prices on domestic demand larger than it would otherwise have been and to further facilitate deleveraging in the euro area. Moreover, easier financing conditions should support lending, confidence, investment and ultimately economic growth. Outside the euro area, several European central banks have also acted to ease monetary conditions further.

These tailwinds, combined with the broadly neutral fiscal stance of the euro area and the EU as a whole, enhance GDP growth this year and next, even though underlying weaknesses and legacies from the crisis remain.

…while structural and crisis-related weaknesses still affect the medium-term outlook.

Stronger economic growth should lead to further improvements in labour market conditions, which in turn should feed private consumption. Higher demand and a somewhat lower need for balance-sheet adjustment, should support investment and thereby help the economic recovery to become more sustainable. Whether the pace of economic activity growth can be sustained beyond this short term outlook, however, will depend on potential growth and thus on a sustained rebound in investment. Structural reforms implemented so far are starting to bear fruit in some Member States but overall remain insufficient to definitively overcome legacies of the crisis and significantly increase medium-term growth potentials.

Global growth is set to accelerate only moderately …

The outlook for economic growth around the world is uneven. Income transfers from oil producers to oil consumers, monetary policy easing in several places and exchange rate movements contribute to this differentiated outlook.

Pushed by the gradual recovery in advanced economies, global growth (excluding the EU) is expected to stabilise at 3.8% this year and pick up moderately to 4.3% in 2016, just a notch lower than expected in the winter. Despite the weather-related weakness at the start of the year, the robust momentum of economic growth in the US is expected to strengthen throughout 2015, as private consumption is boosted by a strong labour market and real income gains stemming from low oil prices and the strong dollar, although the US currency's strength will likely act as a drag on net exports and activity going forward. After having stagnated last year, economic activity in Japan is expected to rebound in 2015 and 2016, triggered by accommodative monetary policy and low oil prices.

Growth in emerging markets economies (EMEs) is expected to remain steady overall in 2015 and to pick up a little in 2016. The improved outlook for India contrasts with weaker prospects for many other EMEs on the back of geopolitical tensions, lower prices for commodity exports and the incidence of some structural domestic bottlenecks and imbalances. In China, GDP growth appears to be slowing in a remarkably controlled manner towards the authorities' target of 7% following their deliberate strategy to rebalance growth.

...supporting some acceleration of EU Member States export markets ...

The momentum of world trade weakened at the turn of the year as imports in EMEs were particularly weak (mainly in Russia and oil exporting countries), but world trade is expected to accelerate moderately, triggered by the expansion of the global economy, and will underpin an acceleration of EU Member States' export markets over the forecast horizon.

Expectations about a divergence in monetary policy between the euro area and other large economies, itself driven by delayed recovery in the former, have become a key factor for foreign exchange rates. The euro has experienced large swings vis-à-vis some other major currencies since the beginning of this year. While the euro has weakened substantially against the US dollar and the pound sterling, it has experienced more limited movements against most other EU currencies in the context of accommodative monetary policy actions taken by several central banks in the EU.

...while the ECB's QE has eased financial conditions.

Financial conditions in the euro area have eased since November, when expectations about QE became stronger. These movements continued after the announcement of the expanded APP in January 2015 and its actual implementation in March. The effects of these non-standard monetary policy tools on financial markets have been even stronger than expected. Euro area sovereign bond yields have been driven down significantly and sovereign yield curves, which constitute a benchmark for the pricing of a vast array of credit instruments and forms of external finance for the private sector, have flattened. Supported also by more positive news on economic activity, stock markets across the EU have firmed strongly since the start of the year and corporate bond spreads have tightened, lowering financing costs for European companies.

Bank lending to the private sector continues to recover, with net lending flows to non-financial corporations becoming gradually less negative and credit standards on loans to enterprises easing further. The ECB's expanded APP is expected to add some further momentum by improving the liquidity position of banks. Last year's asset quality review showed that banks are, overall, better capitalised than during the crisis and hence, in a better position to withstand losses on outstanding loans to the private sector. However, in some Member States, relatively low capital buffers and high levels of non-performing loans may impair the transmission of the ECB's QE into bank lending.

Tailwinds will push activity in EU Member States to a different degree ...

All countries in the EU are set to benefit from a rare conjunction of positive factors, but not necessarily to the same degree. Differences in the pass-through of lower oil prices and, in the euro area, a varying effect of the depreciation of the euro according to the price elasticity of exports and the openness to trade with non-euro area countries will modulate their impact. Transmission channels for QE, other than the exchange rate, are also likely to differ across countries. The decline in real interest rates should, for instance, be larger in peripheral countries that had wider spreads before QE was announced. On the other hand, in some peripheral countries, the fragility of financial systems and the high level of non-performing loans may hinder the conversion of extra liquidity into more lending to the private sector.

Among the largest Member States, GDP growth is expected to be above the EU average in Poland, Spain and the UK. Economic activity should stay robust in *Poland* on the back of solid domestic demand. In *Spain*, the recovery is accelerating this year, supported by improved labour market and financing conditions, although a moderation in growth is expected next year.

Growth in the *UK* is expected to remain robust but to slow this year and next as investment growth cools. In *Germany*, economic growth is expected to be driven by exceptionally robust domestic demand with private consumption underpinned by an improving labour market. Economic activity in *France* is expected to slowly gain momentum thanks to private consumption, but the delay in the recovery of investment is keeping GDP growth below the euro area average. *Italy*'s economy is expected to return to growth this year, thanks to increasing external demand, and to strengthen next year once investment picks up. Although short-term deleveraging pressures are expected to abate in *the Netherlands*, they will continue to limit the potential for a faster recovery.

Among the euro area Member States that have, or have had, adjustment programmes, growth is expected to remain robust in *Ireland* but to turn positive only next year in *Cyprus*. Economic growth is gathering momentum in *Portugal* thanks to improved domestic demand and strong exports. In *Greece*, policy uncertainty has already weakened confidence and is affecting the pace of the incipient recovery.

…but will broadly support domestic demand …

Domestic demand is expected to accelerate over the forecast horizon and to remain the main contributor to GDP growth in the EU and the euro area. This mainly reflects the expansion of private consumption expected this year and a rebound of investment next year.

Although some crisis-related factors continue to weigh on investment, particularly in the euro area, investment is forecast to slightly strengthen this year and to resurge more strongly in 2016. Equipment investment should gain traction supported by stronger domestic and external demand, improved business sentiment, wider profit margins due to lower energy prices, and lower funding costs. The capacity of companies to fund themselves with internal resources should strengthen thanks to the accumulation of significant cash positions and growing gross operating surpluses, while external funding costs should fall, thanks to the relaxation in lending condition and the decrease in real longer-term interest rates underpinned by the ECB's QE. By reducing the funding costs of investment projects and improving investment conditions, the Investment Plan for Europe should have a positive impact on equipment and construction investment both in the public and private sectors in the coming years. Lower mortgage rates and easing financing conditions are set to lift residential construction, but ongoing adjustments in the housing market are likely to continue acting as a drag in several countries, albeit to a lesser extent in 2016 than in 2015.

Enhanced by the rise in nominal compensation being driven by slight improvements in labour market conditions and strong growth in non-labour incomes, households' nominal disposable incomes should register a marked rise. At the same time, the very low rate of inflation will translate into strong increases in real disposable incomes. Household's more favourable financial situation and more favourable financing conditions should impact positively on household spending decisions. A slight increase in their saving ratio is nevertheless projected this year, since households are expected to save a portion of the energy price windfall in an attempt to smoothen inter-temporal consumption. As oil prices are assumed to rebound gradually, the large purchasing power lift to households should slowly fade next year, cooling private consumption. However, with deleveraging needs diminishing, consumer confidence picking up and unemployment declining further, the

saving ratio should stop increasing in 2016, and private consumption growth should only slightly decelerate.

…while the lower euro is an opportunity for exporters to restore their profit margins …

Helped by stronger global import demand and the euro's depreciation (about 9% in nominal effective terms in 2015 compared to 2014), EU exports should accelerate this year and next. However, increased price competitiveness due to the euro's depreciation is expected to translate only partly into higher sales volumes. Indeed, euro area exporters, as well as firms that compete with importers in the domestic market, are expected to also restore their profit margins. Still, countries that have implemented structural reforms are expected to see an improvement in their export performance. In line with the strengthening in domestic and external demand, imports of goods and services are set to accelerate over the forecast horizon. Overall, net exports should have an almost neutral impact on GDP growth in both areas and both years.

…and will also help normalise inflation.

Inflation in the EU and the euro area fell in late 2014 and early 2015, dropping below zero in December on account of the continued sharp fall in energy prices. Despite the recent rebound in oil prices, which has been stronger in euro terms, inflation is expected to be negative for the first half of this year, partly due to negative base effects from the earlier fall of the HICP energy component. Later this year, and more noticeably in 2016, the expected strengthening of domestic demand, combined with a narrowing of the output gap, fading effects of lower commodity prices and progressively higher import prices triggered by the depreciation of the euro, should result in gradually higher inflation rates. Inflation expectations, which recovered when the ECB announced its expanded APP, signal low but positive inflation in the next few years. Annual HICP inflation in both the EU and the euro area is expected to rise from 0.1 % this year to 1.5 % next year.

The fiscal outlook is improving and the aggregated stance will be broadly neutral …

The fiscal outlook is improving. The deficit–to-GDP ratio in the EU and the euro area is estimated to have decreased to 2.9% and 2.4% respectively in 2014. In the euro area, the non-standard monetary policy measures taken by the ECB are expected to have some positive impact on the fiscal outlook through the decline in borrowing costs and the higher inflation outlook. Supported by the cyclical strengthening of economic activity and to a lesser extent by the further reduction in interest payments on public debt, government deficit ratios are projected to continue falling over this year and next to reach 2.0% of GDP in the EU and 1.7% in the euro area in 2016. Following the substantial fiscal adjustment achieved over the last few years, the aggregated fiscal policy stance in 2014 and 2015 in the EU and the euro area is expected to be broadly neutral. The debt-to-GDP ratio is estimated to have peaked at 88.6% in the EU and at 94.2% in the euro area in 2014, and is expected to decline this year and even more so next year, as nominal GDP growth picks up.

…while progress in the labour market is gradually broadening.

The recovery of the labour market in the EU is progressing and is becoming fairly broad-based across sectors. There are also some signs of convergence among Member States, as employment growth last year was driven to a large extent by improvements in countries with relatively high unemployment rates. Looking ahead, with economic growth expected to strengthen in 2015 and 2016 and wage increases to remain moderate, modest improvements in the labour market are set to continue. Employment is expected to grow in both areas by 0.9 % this year and by 1% in the EU and 1.1% in the euro area next year. The recovery in employment is expected to be relatively strong in countries that recently implemented labour market reforms (e.g. Spain). The

unemployment rate is projected to decline somewhat to 9.2% in the EU and 10.5% in the euro area in 2016, reflecting the persistence of high structural unemployment and large unemployment gaps, as the rise in economic activity is not strong enough for a more marked improvement.

Uncertainty is high but risks are broadly balanced

Overall, the uncertainty surrounding the economic outlook remains high, but risks to the upside and those to the downside are broadly balanced.

On the upside, new developments in oil production could delay the assumed rebound in oil prices and keep the oil-price stimulus in the EU intact for longer than expected. The boost from lower oil prices could also be stronger than currently expected. The impact of the ECB's QE could be larger than forecast if companies' decisions in the euro area are more interest-rate sensitive than assumed and bank lending reacts more strongly than projected, or if the implementation of QE depresses the external value of the euro beyond the technical assumption in this forecast. Finally, pending the finalisation of the on-going discussion on the Investmen Plan for Europe, only a cautious estimate of its impact has been retained in this forecast. This may underestimate the positive impact on total investment growth in the EU and in particular countries.

On the downside, geopolitical tensions in Ukraine and parts of the Middle East and Northern Africa remain high and could further impede economic growth in Europe if they escalate. If oil production adjusts faster than expected to low prices, oil prices could rebound faster than assumed and erase the windfall gains from lower energy prices. Renewed bouts of financial market volatility associated with the expected normalisation of monetary policy in the US, or with a correction in asset values, or stemming from developments related to Greece, could jeopardise the expected improvements in financing costs. Finally, a delay in the implementation of structural reforms would make the rotation of growth drivers from temporary tailwinds towards fundamentally more sound growth determinants more difficult and raise the risk of a long period of very subdued economic growth or stagnation.

Risks surrounding the inflation outlook have moderated as a result of the ECB's quantitative easing and in response to the upward revisions to the growth outlook. This applies in particular to the risk of a substantial decline of longer-term inflation expectations and of negative second-round effects on income stemming from a protracted period of very low or negative inflation.