European Economic Forecast – Winter 2015

Marco Buti, Director General DG ECFIN

EPC Policy Dialogue

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### Forecast in a snapshot

<table>
<thead>
<tr>
<th></th>
<th>Real GDP</th>
<th>Inflation</th>
<th>Unemployment rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>0.1</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Spain</td>
<td>-1.2</td>
<td>1.4</td>
<td>2.3</td>
</tr>
<tr>
<td>France</td>
<td>0.3</td>
<td>0.4</td>
<td>1.0</td>
</tr>
<tr>
<td>Italy</td>
<td>-1.9</td>
<td>-0.5</td>
<td>0.6</td>
</tr>
<tr>
<td>Portugal</td>
<td>-1.4</td>
<td>1.0</td>
<td>1.6</td>
</tr>
<tr>
<td><strong>Euro area</strong></td>
<td>-0.5</td>
<td>0.8</td>
<td>1.3</td>
</tr>
<tr>
<td>Poland</td>
<td>1.7</td>
<td>3.3</td>
<td>3.2</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1.7</td>
<td>2.6</td>
<td>2.6</td>
</tr>
<tr>
<td><strong>EU</strong></td>
<td>0.0</td>
<td>1.3</td>
<td>1.7</td>
</tr>
<tr>
<td>USA</td>
<td>2.2</td>
<td>2.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Japan</td>
<td>1.6</td>
<td>0.4</td>
<td>1.3</td>
</tr>
<tr>
<td>China</td>
<td>7.6</td>
<td>7.4</td>
<td>7.1</td>
</tr>
</tbody>
</table>

- Very gradual and uneven recovery
Steep fall in oil prices

Brent oil spot prices (USD/€)

How large is the bonus?
Monetary policy has eased further, and financial fragmentation has receded.

10-year government bond spreads

Long term inflation expectations

QE effects may surprise on the upside
Euro has depreciated against major peers

**Euro exchange rates, USD and JPY**

**Real and nominal effective exchange rate**

monthly averages (% change March - December 2014)

> Who will benefit most?
Fiscal stance neutral in aggregate is appropriate
Budgetary developments, EU

- Composition and distribution not optimal
Policy measures and lower oil prices stimulating domestic demand

Real GDP growth and its components, EU

Though still subdued
Energy prices drive the fall in inflation

HICP and sub-components, EU

- Energy and unprocessed food [% points]
- Other components (core inflation) [% points]
- HICP, all items

ECB’s move reduces the risk of a debt-deflationary trap
Unemployment slowly declining, but still high

Employment growth and unemployment rate, EU

- Employment (quarter on quarter % change, left scale), forecast (year on year % change, left scale)
- Unemployment rate (right scale)

Forecast figures are annual data.

➢ Past reforms start to pay off
Current-account rebalancing, still lopsided

Current-account balance, EU

"In the long run, we`re all ... in surplus". Or are we?
Structural reforms needed to boost growth and facilitate rebalancing

- Enhance reform responsiveness across the board
Risks to the growth outlook: increased in both directions

Risks on the downside:
- Geopolitical risks
- Renewed financial volatility
- Delayed implementation of structural reforms
- Long period of low inflation

Risks on the upside:
- Full effect of QE
- Further exchange rate depreciation
- Larger impact of low oil prices
- Effect of EU action plan on investment

➢ A bi-modal distribution? Economists and (even more) institutions are not good at spotting turning points
Key messages

EU determined policy response needed to attain the good equilibrium:

- Very accommodative monetary policy appropriate
- Broadly neutral fiscal policy stance: distribution and composition
- The Commission’s guidance on the application of the Stability and Growth Pact
- The EU Investment Plan: implement in all strands
- Structural reforms: step up the gear also in core countries
Thank you for your attention