2014 AUTUMN FORECAST PRESS SPEAKING POINTS - Slow growth amidst very low inflation

Brussels, 04 November 2014

The powerpoint presentation can be found here:

Spokesperson:

Good morning and welcome to this presentation of the European Commission’s 2014 autumn economic forecast.

This forecast has been prepared by the Commission’s Economic and Financial Affairs Directorate General, which was under the responsibility of Vice President Katainen until last Friday, and has been under the responsibility of Commissioner Moscovici since Saturday.

That’s why we are having this joint press conference today by the Vice President and the Commissioner.

Without further ado I will hand over to Vice President Katainen.

**SLIDE ONE continued**

**Vice President Katainen:**

Thank you very much Margaritis. Good morning.

The forecast is about facts and figures. It offers the Commission’s understanding of the economic environment that will guide our further work.

For the new Commission, this is a new start. We are presenting today the situation as it is. And we will soon be presenting specific initiatives to improve it.

And what we will not do today is making any announcements on assessments. This also applies to our analysis of national draft budgetary plans or any possible steps under the Excessive Deficit Procedure.

The Commission will publish its opinions on the Draft Budgetary Plans by the end of November.

**[Slide 2 – Less favourable global economic conditions...]**

Global GDP growth turned out considerably lower than expected in the first half of this year. This was mainly due to the weakness in some advanced and emerging economies but also to rising geopolitical tensions in Ukraine and the Middle East.

Mirroring the evolution of global growth, world trade weakened significantly earlier this year (as can be seen on the graph), revealing a steep contraction of trade flows in emerging markets. Despite a pick up since the summer, the forecast for trade growth has been revised down. [World import growth is expected to reach 3.0 % in 2014, 4.6 % in 2015 and 5.5 % in 2016.]

**[Slide 3 –...have negatively affected confidence]**

Less favourable global economic conditions have negatively affected confidence in the past few months. Economic sentiment [as measured by the Commission’s Economic Sentiment Indicator] had been declining since spring in both the EU and euro area. This decline reflected relatively broad-based developments across countries. In October, however, the index stabilised in both regions and it is now again above its long-term average.

Despite this recent pick up, confidence indicators are consistent with very modest GDP growth in the
Country-specific factors are contributing to the weakness of economic activity in the EU, and the euro area in particular.

Such factors include the deep-seated structural problems that were already well-known before the crisis, the public and private debt overhang; ongoing financial fragmentation related to the sovereign debt crisis.

Obviously, the impact of these factors differs substantially between countries, contributing to macroeconomic differences within the EU.

In 2014, GDP growth is expected to remain negative in Italy (-0.4%), Croatia (-0.7%) and Finland (-0.4%). Activity in France should remain broadly stable (0.3%) while over the year growth remained fairly robust in Germany (1.3%), and accelerated in Spain (1.2%) and in the Netherlands (0.9%). Robust growth is projected for the UK (3.1%) and Poland (3.0%). Ireland is forecast to be the fastest growing country in the EU in 2014, with growth of 4.6%.

Overall, therefore, GDP growth in Europe has been revised down: annual GDP growth in the EU this year is now projected to be 1.3%, while growth in the euro area is expected to be 0.8%.

Some of the factors that held back global growth in the first half of 2014 will probably prove temporary. Notably, in the US, strong momentum in the economy will be supported by an easing of fiscal consolidation and the continuation of accommodative monetary policies. The growth outlook for emerging market economies is supported by relative resilience in emerging Asia, although a gradual deceleration of activity is likely in China. Overall, world GDP growth this year is now expected at 3.3%, increasing to 3.8% in 2015 and 4.1% in 2016.

In Europe, economic activity, should also gradually strengthen over the course of 2015 and accelerate further in 2016. This pick-up will be driven by the legacy of the crisis fading away, structural reforms starting to bear fruit, labour markets improving, and by the presence of more supportive policies and financing conditions.

Against this background, growth in the EU is forecast to rise to 1.5% in 2015 and then increase modestly to 2.0% in 2016, while in the euro area, growth is forecast to reach 1.1% and then 1.7%.

Despite the recent turbulence, financial-market conditions remain overall favourable.

Monetary policy in the euro area has become more accommodative and some Member States outside the euro area have also cut interest rates.

As can be seen on these graphs, bond spreads in vulnerable Member States have, overall, continued to tighten, and corporate bond yields have followed sovereign yields down. These benign developments are starting to translate into decreasing financial fragmentation and lower financing costs for firms. Financing conditions, however, continue to differ widely across Member States.

The ECB's comprehensive assessment of European banks has shown good progress with the strengthening of bank balance sheets. The remaining needs for additional capital appear manageable. This should help in removing credit supply constraints where they are still an issue.

A turning point in euro-area loan dynamics seems to have been reached in the second quarter of the year. Loans to the private sector shrank in September at an annual rate of 0.6% (adjusted for sales and securitisation), thus slower than in the preceding months (e.g. -0.9% in August and -1.6% in April). As shown on the left hand graph, the annual growth rate of loans to non-financial corporations was less negative in September (at -1.8%, from -2.0% in the previous month, adjusted for sales and securitisation) and was slightly positive for households (0.6% y-o-y in September).

The October 2014 ECB Bank Lending Survey (published after our cut-off date) signalled further improvement in both supply and demand for loans. For the third quarter of 2014, banks reported
continued net easing of credit standards for both enterprises and households. Demand was reported to have risen for all types of loans. Looking forward to the fourth quarter of 2014, banks expect further easing of credit conditions and improved demand.

Historical trends show that the credit cycle for non-financial corporations tends to lag the economic cycle by several quarters. Based on this relationship, the bank credit cycle for non-financial corporations is expected to turn positive next year. This improvement, along with ECB policies targeting improved monetary policy transmission, should benefit corporates and households, including SMEs.

**Slide 9: ... a broadly neutral fiscal stance**

The reduction in general government deficits is set to continue.

The deficit-to-GDP ratios in both the EU and the euro area are projected to decrease further this year, albeit more slowly than in 2013. It is expected at 3.0 % in the euro area and 2.6 % in the EU. Government deficits are forecast to continue falling over the next two years, helped by strengthening economic activity.

The fiscal policy stance is expected to be broadly neutral in 2014 and 2015, as the changes to the structural balance, should be broadly nil in both years.

The debt-to-GDP ratios of the EU and the euro area are now expected to peak only next year at 88.3 % and 94.7 % respectively, as the continued improvement of primary surpluses and stronger economic growth are likely to be offset by interest expenditure.

I will now hand over to Pierre for the second half of this presentation.

**[Slide 10 – Domestic demand to drive output growth]**

**Commissioner Moscovici:**

Merci Jyrki.

La demande intérieure serait le principal moteur de croissance au cours des deux prochaines années. Elle bénéficierait d'une politique monétaire très accommodante, de faibles coûts de financement, de conditions d'offre de crédit plus favorables, d'un moindre ajustement des bilans du secteur privé et de l'orientation globalement neutre de la politique budgétaire dans l'UE.

La consommation privée progresserait modérément en 2015 et 2016, soutenue par les faibles prix des matières premières et par l'augmentation des revenus, suite à l'amélioration graduelle du marché du travail que nous prévoyons.

La consommation publique contribuerait également marginalement à la croissance.

**[Slide 11: A gradual recovery of investment]**

La faiblesse de l’investissement a été un facteur déterminant pour expliquer la croissance économique atone que nous avons connue. Comme vous pouvez le voir sur ce graphique, l'investissement reste largement inférieur au niveau qu'il atteignait avant la crise, et ceci, tant pour l'Union européenne dans son ensemble que pour la zone euro. Il ne s'agit pas là d'une caractéristique propre aux seuls pays vulnérables.

Un encadré de notre publication explique que cette faiblesse de l'investissement reflète une faible croissance de la demande, de bas taux d'utilisation des capacités de production, une incertitude économique et politique élevée, et, dans certains pays, des contraintes financières ainsi que la volonté des entreprises de réduire leur haut taux d'endettement.

Une accélération de l'investissement est indispensable pour assurer une reprise plus marquée.

Selon nos prévisions, l'investissement privé devrait progressivement repartir car l'ajustement des bilans du secteur privé progresse, et également en raison d'une amélioration des perspectives de demande.

Cependant, à court terme, les capacités de production excédentaires pèseront encore sur l'investissement

L'investissement en équipement devrait accélérer en 2016 seulement, grâce à l'accélération de l'activité, tandis que l'investissement en construction se rétablira de manière plus constante mais aussi plus modérée.
Labour markets are improving only slowly

Recovery of the labour market in the EU is progressing but remains subdued, because of the weakness of economic activity.

The current pace of economic activity does not allow for rapid and massive absorption of excess capacities. Employment growth in 2014 and 2015 is thus expected to be limited. Supported by the economic recovery and the moderation shown in past wage increases, employment growth should gain speed in 2016.

As a result, the unemployment rate should fall slowly to 9.5% in the EU and 10.8% in the euro area in 2016, which is still above pre-crisis levels.

The overall slow decline in unemployment rates reflects cyclical factors such as the sluggishness of the recovery, but also the persistence of high structural unemployment.

Our estimates show that structural unemployment has been steadily increasing since 2009 in both the EU and the euro area.

Looking ahead, it is expected to continue rising in the euro area over the forecast horizon, though more moderately than during the crisis period and to stabilise in the EU.

In 2015, most EU economies will grow at more than 1%

While the expected strength of the recovery will continue to differ across countries, growth differences are expected to continue declining over the next two years. As you can see from the growth map for 2015, all EU economies are expected to be growing again by next year.

Let me comment on some Member States specifically:

First, among the largest Member States.

Growth in Germany weakened in the course of this year, but is expected to pick up again, to 1.1% next year, on the back of the robust labour market and strengthening external demand, while domestic investment is projected to remain subdued.

France is expected to register only very slow growth of 0.7% in 2015 amid a subdued pace of private consumption and still contracting investment.

In Italy, GDP growth is projected to turn positive early next year, as growing external demand drives a still fragile recovery. GDP growth in 2015 is expected at 0.6%.

In Spain, GDP growth is set to accelerate again to 1.7% next year, supported by employment growth and easier financing conditions.

Growth in the Netherlands is expected to firm at 1.4% in 2015, as private consumption picks up again on the back of stabilising unemployment and a gradually recovering housing market.

Outside the euro area, the United Kingdom is set to see robust growth of 2.7%, as both investment and consumption expand at a fast pace.

Growth in Poland has moderated on the back of weaker external demand, but private consumption is set to support a still healthy expansion. In 2015, GDP growth is expected at 2.8%, down from 3.0% this year.

Now turning to the current or former programme countries, most of these are now catching up on the growth front.

Ireland is expected to be the fastest growing country in the EU over the forecast horizon. In 2015, output growth is expected at 3.6%.

Growth in Greece is expected to be substantially above the EU average next year, at 2.9%, and close to the average in Portugal, at 1.3%.

In Cyprus, the downturn this year is expected to be less severe than previously forecast and a modest recovery is expected to begin in 2015, with output growth expected at 0.4%.

Of course faster growth in these countries has to be seen against the backdrop of the large output losses during the crisis, but it remains an encouraging sign that adjustment and reform process is working.
Finally, in most of the Member States that joined the EU in the past decade, output is growing faster as the process of real convergence has resumed.

[Slide 14: Country differences also narrowing in labour markets]
Differences in labour market performances across Member States remain sizable but have started narrowing, thanks to improvements in stressed countries. Looking ahead, these differences are expected to continue narrowing over the next two years, although they will remain very large. Unemployment rates are expected to range from around 5% in Germany to still over 20% in Greece and Spain in 2015.

[Slide 15 – Low inflation is persisting]
The trend towards lower inflation in EU Member States has continued lately. It has been driven by lower commodity prices, especially for energy and food, the weaker-than-expected economic environment, and the euro’s earlier appreciation.

Some Member States also experience very low, or negative, inflation rates as part of their necessary adjustment process.

In the near term, weak output and weak commodity prices should continue to dampen inflation over the rest of 2014. As economic activity gradually strengthens and wages rise, however, inflation should increase, also fuelled by the waning impact of low energy prices and slightly higher import prices due to the depreciation of the euro.

Inflation is now forecast to be around ½ % this year, but to rise to about 1% in 2015 and to 1½ % in 2016.

[Slide 16: Risks to the growth outlook remain tilted to the downside]
Downside risks to the growth outlook still dominate, in particular related to geopolitical tensions, possible market reactions to the normalisation of monetary policy in the US and risks related to the pace of reform implementation in Europe.

Risks to the inflation outlook remain balanced. While some downside risks appear to be more acute than previously assessed, others have partly materialised and been incorporated into the central scenario.

[Slide 17: No single, simple answer]
Let me conclude here. The economic recovery is clearly struggling to gather momentum in much of Europe. We believe that it is essential that all levels of government assume their responsibility and mobilise both demand- and supply-side policies to boost growth and employment.

There is no magic bullet, no simple answer.

All Member States need determined structural reforms, credible fiscal policies and support to investment. For the euro area in particular, policies will be most effective if closely coordinated.

Our first priority now is to boost investment, to kick-start growth and sustain it over time. We will be working at full speed, under the coordination by Vice-President Katainen, to put in place the 300 bn investment plan announced by President Juncker.

Thank you very much.

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