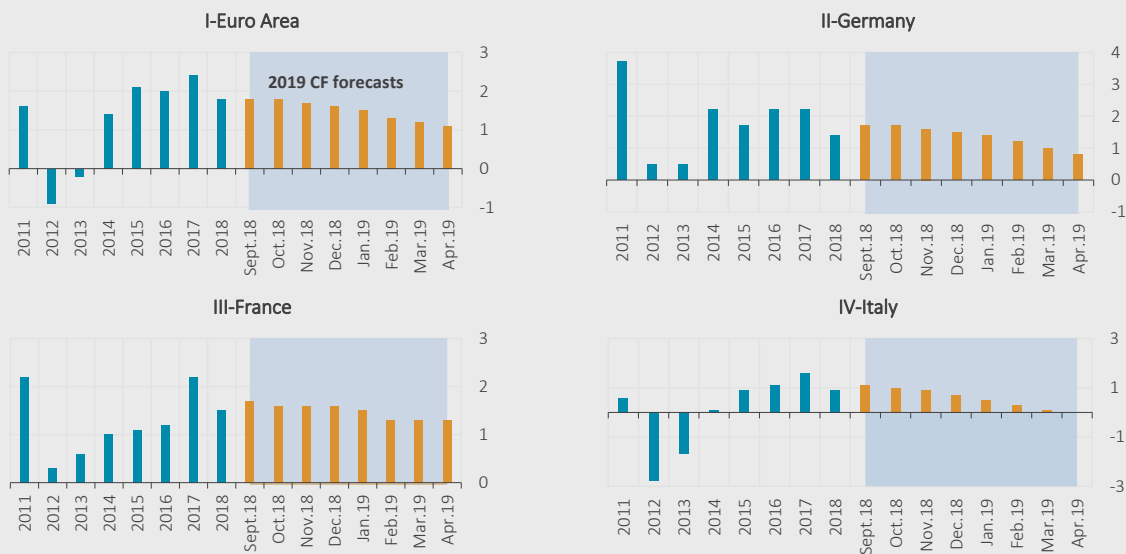


Box 2.1

Euro Area Economic Outlook

Euro Area sustained the favorable economic performance of 2017 during the first quarter of 2018. However, the deceleration in growth in the second quarter became more evident in the second half. In addition to the heightened global economic policy uncertainty due to the US-China trade dispute, Chinese economic slowdown and political uncertainties in the Euro Area such as successive elections and the Brexit process, led to a drop in consumer and investor confidence; a feature of the economic weakening (Figure 1).

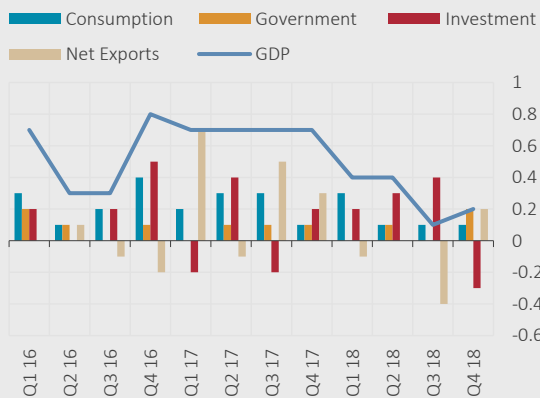
Figure 1: Euro Area Growth Rates and 2019 End-Year Consensus Forecasts (CF) Updates (%)



Source: Bloomberg, Consensus Forecasts.

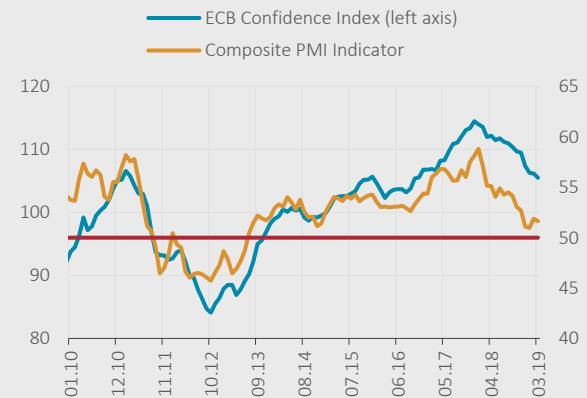
The weakening in manufacturing industry stemming from external demand moderation, stands out as a major factor in the slowdown in the economic activity (Figure 2). Nevertheless, there is no uniform moderation across the Euro Area countries. While the Italian slowdown was mainly due to domestic developments stemming from fiscal policies, the slowdown in Germany, which has the strongest economic activity in the Euro Area, was mainly driven by weakening exports. On the other hand, the political tension in France is thought to have had an unfavorable impact on economic growth.

Figure 2: Euro Area Contributions to Growth (GDP %, contributions percentage points)



Source: EUROSTAT.

Figure 3: Leading Indicators of Economic Activity

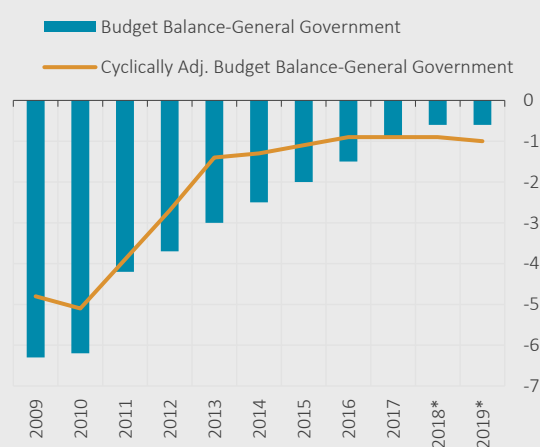


Source: ECB, Markit.

The whys and wherefores of the Euro Area slowdown is not expected to improve in 2019, and by extension the slowdown in the economic activity of the Euro Area either. The uncertainties in the world trade originating from the US trade policies are anticipated to be at the forefront of this year's agenda as well. In particular, the uncertainties over whether the US may impose customs duties on automobile exports from the Euro Area and delays in the implementation of new emission standards in Germany may adversely affect economic activity in the Euro Area, the most important automobile manufacturer and exporter in the world economy. As a matter of fact, the World Trade Organization has revised its 2019 global trade volume growth forecasts downwards significantly.¹ Similarly, political uncertainties remain in the region. The European Parliament elections due in May, and the Brexit process are considered as the most important sources of political uncertainty in 2019.

On the other hand, the positive developments in the labor market, notably the ongoing decrease in the unemployment rate and the improvement in budget balance (Figure 4), are factors that may positively affect the growth of the Euro Area. In addition, the Euro Area presents a relatively more affirmative outlook for private sector indebtedness than other major economies of the world (Figure 5). Despite these advancements, uncertainties originating from global trade and regional politics are expected to be more decisive on growth of the Euro Area in 2019. Leading indicators show that the slowdown in economic activity crystallized in the first quarter of the year (Figure 3). Indeed, the fact that the 2019 growth forecasts in the Consensus Forecasts Bulletins have been down across the Euro Area as well as in countries individually in every update period since September 2018, supports this expectation (Figure 1).

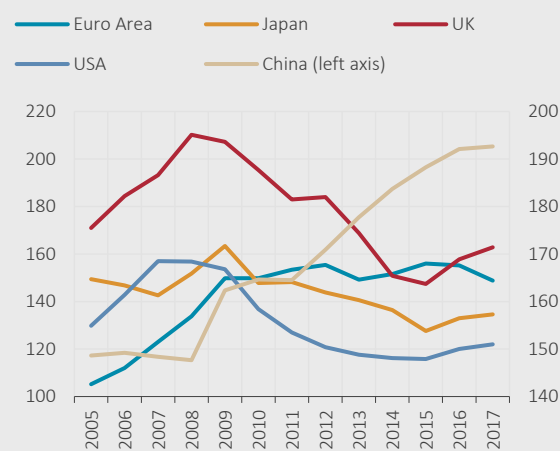
Figure 4: Euro Area Budget Balance (%)



Source: EUROSTAT.

* Forecast.

Figure 5: Private Sector Debt/GDP



Source: BIS.

All in all, due to the lingering uncertainties regarding global trade and regional politics, the economic slowdown in the Euro Area is expected to continue in 2019 and the growth rate to decline.

¹The World Trade Organization, which announced its global trade volume growth forecast as 3 percent, revised its forecast down to 2.6 percent. https://www.wto.org/english/news_e/pres19_e/pr837_e.htm.