EUROPEAN ECONOMIC OUTLOOK

Strong rebound and temporary rise in inflation

- **Overview** – The euro-zone is on the way to an almost full recovery. We expect Germany to regain its pre-pandemic level of activity later this year and the tourist-dependent southern countries to do so next year. The Delta variant may lead to some voluntary social distancing or self-isolating and perhaps limited restrictions over the winter, but we doubt that it will derail the recovery. Inflation will rise further than most expect in the coming months due to rising input costs and supply bottlenecks. But with wage agreements and inflation expectations remaining low, it will drop back and stay lower than most expect over the medium term. The ECB is likely to step up its standard Asset Purchase Programme substantially when its emergency purchases end next March and leave its deposit rate at -0.5% until beyond 2025, which is much later than investors expect.

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Key Forecasts

Table 1: Real GDP and Consumer Prices (% y/y)

	Share of World (%)	GDP				Consumer Prices (HICP)			
		2020	2021f	2022f	2023f	2020	2021f	2022f	2023f
Germany	3.5	-5.1	4.0	4.5	0.8	0.4	2.8	1.5	1.5
France	2.4	-8.0	6.3	3.8	1.3	0.5	1.8	1.3	1.0
Italy	2.0	-8.9	5.5	4.0	1.5	-0.1	1.3	0.5	0.5
Spain	1.5	-10.8	5.5	6.5	2.5	-0.3	2.3	1.0	0.8
Netherlands	0.8	-3.8	3.8	4.5	2.3	1.1	2.3	1.8	1.5
Belgium	0.46	-6.3	5.8	3.5	2.8	0.4	2.0	1.6	1.3
Austria	0.39	-6.4	3.5	5.5	0.8	1.4	2.5	2.0	1.5
Ireland	0.34	2.5	7.0	3.5	2.5	-0.5	1.5	1.0	0.5
Greece	0.28	-8.2	8.0	2.0	1.3	-1.3	0.3	0.5	0.5
Portugal	0.25	-7.6	2.3	5.5	2.5	-0.1	0.5	0.5	0.3
Finland	0.21	-2.7	2.5	2.8	1.5	0.4	1.8	1.3	1.0
Slovakia	0.14	-4.8	4.8	5.5	4.0	2.0	1.8	2.0	2.0
Slovenia	0.06	-5.5	6.0	2.8	1.5	-0.3	1.5	1.0	0.8
Luxembourg	0.06	-1.3	4.8	3.0	3.0	0.0	2.5	2.0	1.5
Cyprus	0.03	-5.1	4.8	2.5	2.3	-1.1	1.5	1.3	1.0
Euro-zone	**11.4**	**-6.7**	**5.0**	**4.5**	**1.5**	**0.3**	**2.3**	**1.3**	**1.0**

Sources: Refinitiv, Capital Economics.

Table 2: Quarterly Euro-zone Forecasts

	2021				2022				2023				Annual (% y/y)		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2021	2022	2023
GDP (% q/q)	-0.3	1.5	2.8	1.4	0.9	0.7	0.4	0.4	0.3	0.3	0.3	0.3	5.0	4.5	1.5
Private Consumption (% q/q)	-2.3	3.3	3.8	2.0	1.2	0.9	0.7	0.6	0.4	0.4	0.4	0.4	3.5	6.7	1.9
Total Fixed Invest. (% q/q)	0.2	1.5	2.0	1.2	1.0	0.7	0.4	0.4	0.4	0.4	0.4	0.4	6.5	4.1	1.7
Gov't. Consumption (% q/q)	0.0	0.0	0.0	0.0	-0.2	-0.2	-0.2	-0.2	0.1	0.1	0.1	0.1	2.2	-0.5	-0.1
Exports (% q/q)	1.0	1.3	2.3	1.5	1.0	1.0	0.8	0.7	0.6	0.6	0.6	0.6	9.0	5.0	2.7
Imports (% q/q)	0.9	1.7	1.7	1.5	1.0	0.9	0.9	0.7	0.7	0.7	0.7	0.7	7.1	4.8	2.9
Headline Inflation (%)[1]	1.1	1.8	2.6	3.1	1.8	1.6	1.1	0.9	0.9	1.0	1.0	0.9	2.3	1.3	1.0
Core Inflation (%)[1]	1.1	0.9	1.5	2.1	1.3	1.7	1.3	1.1	1.1	1.1	1.2	1.2	1.4	1.3	1.0
Unemployment Rate (%)[1]	8.2	8.0	7.8	7.6	7.4	7.3	7.2	7.2	7.1	7.1	7.0	7.1	8.0	7.3	7.0
ECB Refinancing Rate (%)[2]	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
ECB Deposit Rate (%)[2]	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
ECB Monthly Asset Purch.(€bn)[1]	83	100	100	80	65	60	60	60	40	40	40	40	--	--	--

Source: Refinitiv, Capital Economics. 1) Average over period. 2) End-period

Key Forecasts (cont.)

Table 3: 10-Year Bond Yields

% year-end	Latest (15 July)	2018	2019	2020	2021f	2022f	2023f
Germany	-0.33	+0.24	-0.18	-0.57	-0.25	0.00	+0.25
France	0.00	+0.71	+0.09	-0.40	+0.10	+0.35	+0.60
Italy	+0.72	+2.76	+1.32	+0.53	+0.75	+1.00	+1.25
Spain	+0.31	+1.42	+0.48	+0.06	+0.40	+0.65	+0.90
Netherlands	-0.22	+0.39	-0.05	-0.56	-0.15	+0.10	+0.35
Belgium	-0.03	+0.78	+0.10	-0.39	+0.10	+0.35	+0.60
Austria	-0.12	+0.50	+0.03	-0.51	0.00	+0.25	+0.50
Portugal	+0.28	+0.60	-0.10	-0.57	+0.40	+0.65	+0.90
Greece	+0.70	+5.00	+1.89	+1.00	+0.75	+1.00	+1.25
Ireland	+0.04	+1.73	+0.44	+0.05	+0.10	+0.35	+0.60
Finland	-0.17	+0.55	+0.05	-0.48	-0.10	+0.15	+0.40

Sources: Refinitiv, Capital Economics

Table 4: Exchange Rates (per euro)

Year-end	Latest (15 July)	2018	2019	2020	2021f	2022f	2023f
UK	0.85	0.90	0.85	0.90	0.85	0.85	0.85
US	1.18	1.14	1.12	1.22	1.15	1.15	1.20
Japan	132	125	122	126	132	132	138

Sources: Refinitiv, Capital Economics

Table 5: Euro-zone Equities

Year-end	Latest (14 Jul)	2018	2019	2020	2021f	2022f	2023f
Euro-zone – Eurostoxx50	4100	3,001	3,745	3,553	4,100	4,300	4,700
Germany – DAX 30	15,789	10,559	13,250	13,719	15,900	16,700	17,800
France – CAC 40	6,558	4,731	5,978	5,551	6,700	7,000	7,400
Italy – FTSE MIB	25,194	18,324	20,506	22,233	25,200	28,000	30,000
Spain – IBEX 35	8,658	8,540	9,549	8,074	8,800	9,600	10,200

Sources: Refinitiv, Capital Economics

Coronavirus

Delta variant will not stop re-opening

- **Our working assumption is that governments lift all remaining significant containment measures soon and do not re-impose them. The spread of the Delta variant is the key risk to this view, but we suspect that it will prompt only a modest level of restrictions.**

- After falling steadily between April and June, the number of new cases has begun to rise again. (See Chart 1.) This has been most apparent in Spain but there have also been increases in other countries. (See Chart 2.)

- Experience outside the euro-zone suggests that the highly transmissible Delta variant will soon become the dominant strain. (See Chart 3.) It is less clear whether this will force governments into a new round of restrictions which dampen economic activity.

- The evidence so far shows that a substantial increase in the prevalence of the virus need not put excessive pressure on healthcare systems provided vaccination rates are high enough. For example, the UK has experienced a twenty-fold increase in daily cases since May, but the number of hospitalisations has risen only slightly. (See Chart 4.)

- After a shaky start, the EU's vaccine rollout has accelerated dramatically in the past three months. The pace of vaccinations in the four largest economies has exceeded 0.8% of the population per day since the start of June – faster pace than in the UK. While Europe still lags behind the world leaders on total vaccines administered, the gap is narrowing.

- Around 70% of adults in the euro-zone have now received a first dose. The pace of vaccination has varied between countries with Spain leading the pack among the larger ones. (See Chart 5.) The pace in France has been somewhat slower.

- In theory, this rate of progress is sufficient for the entire adult population of the euro-zone to have received at least one dose by September. (See Chart 6.) Of course, not everybody will want to be vaccinated, but the number of people refusing the jab has been smaller than many feared. And the decision to make jabs mandatory for some sectors (such as social care in France) along with the use of vaccine passports should encourage uptake.

- The number of patients in intensive care remains relatively low. (See Chart 7.) And fatalities are much lower than during earlier phases of the pandemic. (See Chart 8.) Our economic forecasts assume that this decoupling of acute illness from total virus cases means that the few remaining restrictions, other than on international travel, will be lifted and that they are not re-introduced in the next couple of years.

- Of course, policymakers may be forced to reverse course if the total caseload increases at an explosive pace in the coming months: indeed, the Netherlands has already closed night clubs again and re-introduced restrictions on bars and restaurants. But any new restrictions seem likely to be confined to small sectors of the economy, plus international travel, so the economic consequences should be modest.

- The unquantifiable tail risk is that new variants emerge which are resistant to the current generation of vaccines. If so, governments would have little choice but to introduce new lockdowns with bigger consequences for economic activity.

Coronavirus Charts

Chart 1: Euro-zone Confirmed Infections

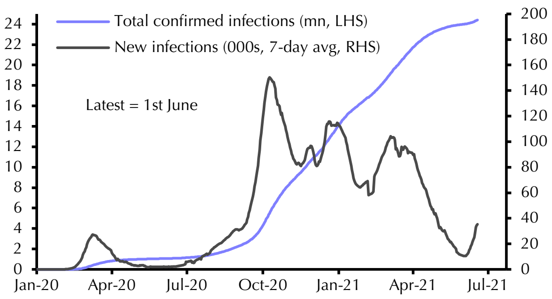


Chart 2: New Infections (7-day M.A, Per Mn Pop.)

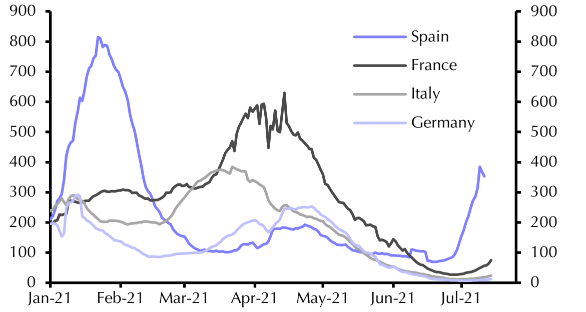


Chart 3: Delta Variant Share of Total Infections (%)

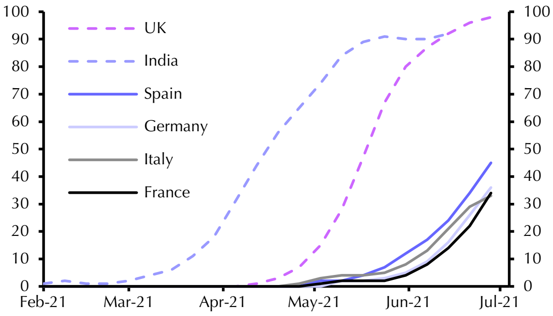


Chart 4: UK Confirmed Cases & Patients in Hospital

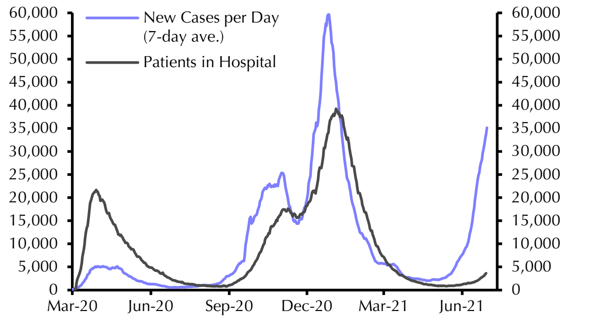


Chart 5: New Vaccine Doses Administered (7-day avg per 100)

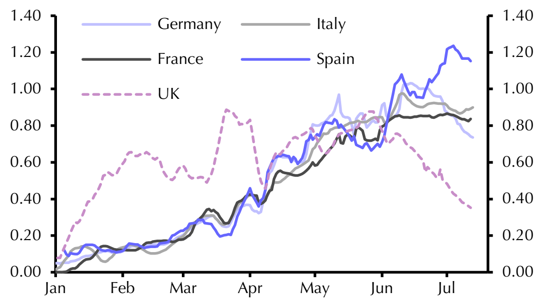


Chart 6: Share of Adult Population Given One Vaccine Dose (%, Latest as of w/e 4th July)

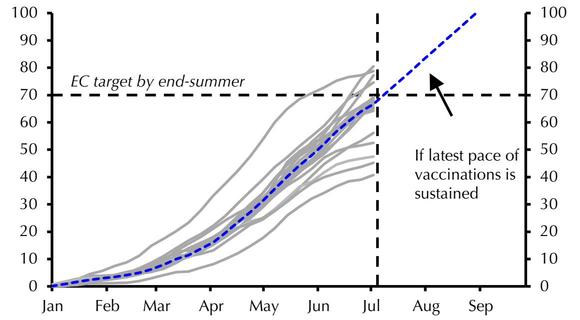


Chart 7: Number of People in Intensive Care

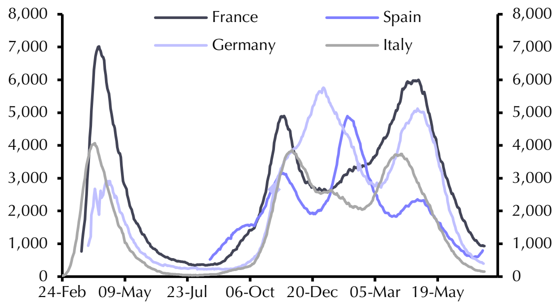
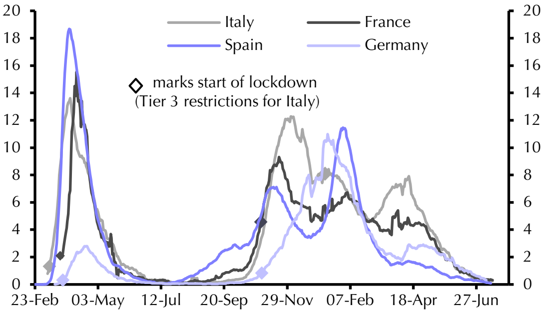


Chart 8: Daily Deaths (7-day M.A, Per Mn Pop.)



Sources: WHO, National Health Ministries, ECDC, CEIC, CE

Euro-zone

Strong rebound and weak underlying inflation

- **The rapid recovery which is now underway should lift euro-zone GDP to its pre-pandemic level early next year. Inflation will rise in the coming months but drop back in 2022, and the ECB will persist with its ultra-loose monetary policy for several more years.**

- High frequency evidence on mobility (see Chart 9) and the limited hard data published so far show that the euro-zone economy is experiencing a strong rebound. The manufacturing PMI is at a record high and the service PMI not far behind. (See Chart 10.)

- Household consumption, which was nearly 10% below pre-pandemic levels in the first quarter, is springing back to pre-Covid levels as restrictions are lifted. And although job support schemes will be wound down, rapid hiring should prevent a significant increase in unemployment. (See Chart 11.)

- Excess household savings, worth 6% of GDP by Q1, should help to sustain consumer confidence. (See Chart 12.) We are not forecasting savings to be run down rapidly because they are concentrated among wealthier households.

- After remaining very high this year, national budget deficits will fall automatically next year as the economy recovers. And the EU Recovery Fund will provide a modest boost to demand: it is worth over 5% of EU GDP and will be disbursed over a six-year period.

- We expect long-term scarring to be quite limited, so after rebounding this year and next, the economy should stay close to its pre-pandemic path. This would be a much better outcome than after the global financial crisis. (See Chart 13.)

- Inflation is likely to rise to over 3% by the end of this year due to base effects, tax changes and supply bottlenecks. This is above the consensus forecast. But the increase will be much smaller than in the US because inflation fell less in the euro-zone last year and there has been less policy stimulus. With little chance of wages rising sharply, inflation should fall back next year and then stay very subdued beyond that. (See Chart 14.)

- The ECB is likely to gradually slow its emergency asset purchases in the coming months and end them next March. Based on its new mandate and our inflation forecasts, however, we think it will then step up its standard Asset Purchase Programme to €60bn per month (see Chart 15), which is twice as much as the consensus forecast. The ECB will also leave its deposit rate at -0.5% until beyond 2025, which is a lot later than investors are assuming. (See Chart 16.)

Table 6: Key Forecasts (% y/y, unless stated)

	Ave.		Forecasts		
	10-19	2020	2021	2022	2023
GDP	1.4	-6.7	5.0	4.5	1.5
Private cons'ptn	0.9	-8.0	3.5	6.7	1.9
Total fixed invest.	1.9	-8.4	6.5	4.1	1.7
Gov't. cons'ptn	0.9	1.4	2.2	-0.5	-0.1
Dom'stic demand	1.1	-6.4	4.0	4.4	1.5
Exports	4.8	-9.6	9.0	5.0	2.7
Imports	4.4	-9.1	7.1	4.8	2.9
Current account[1]	1.9	2.1	2.4	2.3	2.4
Headline Inflation	1.4	0.3	2.3	1.3	1.0
Core Inflation	1.6	0.7	1.4	1.3	1.0
Employment	0.6	-1.5	1.0	1.8	0.8
Unemp. rate[2]	10.2	7.9	8.0	7.3	7.0
ECB Deposit Rate[3]	-0.2	-0.5	-0.5	-0.5	-0.5
Gen'l gov't bal.[1]	-2.5	-7.2	-7.0	-3.8	-2.5
Gen'l gov't debt[1]	89	98	98	97	95

Sources: Refinitiv, Capital Economics
1) % of GDP, 2) % of disposable income, 3) % year avg

Euro-zone Charts

Chart 9: CE Mobility Trackers (cf. early 2020)

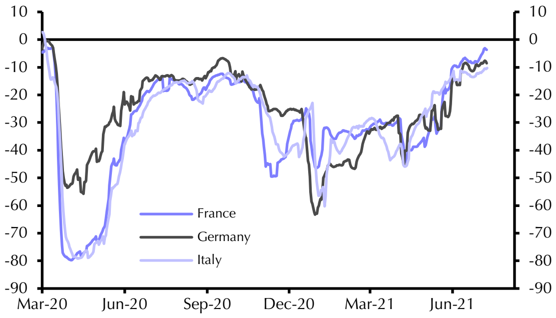


Chart 10: Manufacturing and Services PMIs

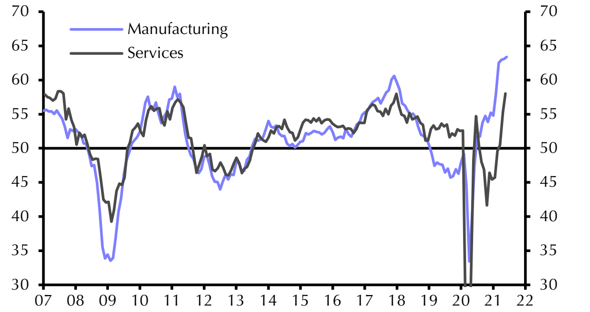


Chart 11: Euro-zone Employment & PMI Employment

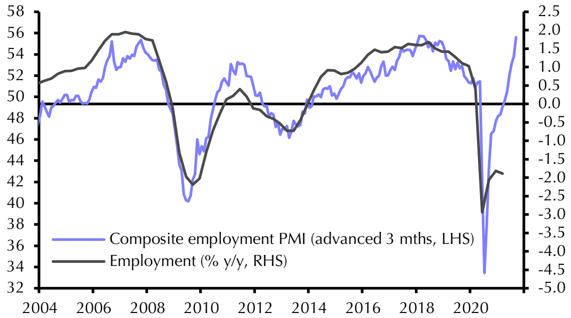


Chart 12: Euro-zone Household Saving (€bn)

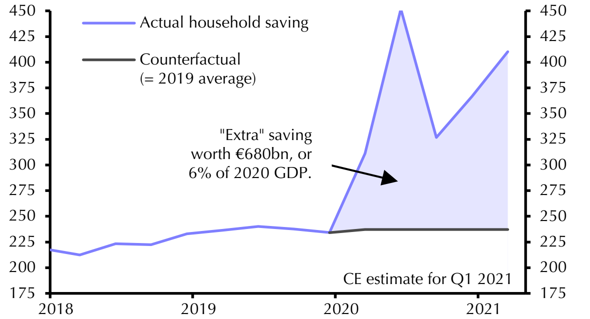


Chart 13: GDP (Q4 2019 = 100)

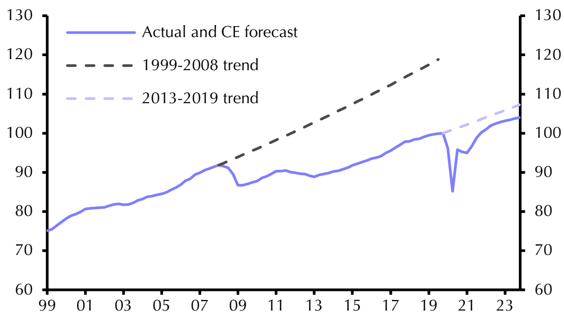


Chart 14: Euro-zone Inflation (%)

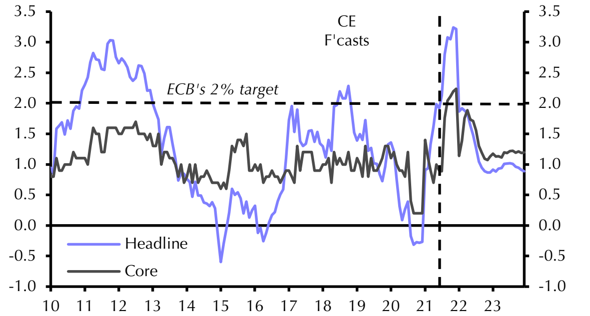


Chart 15: ECB Asset Purchases (€bn Per Month)

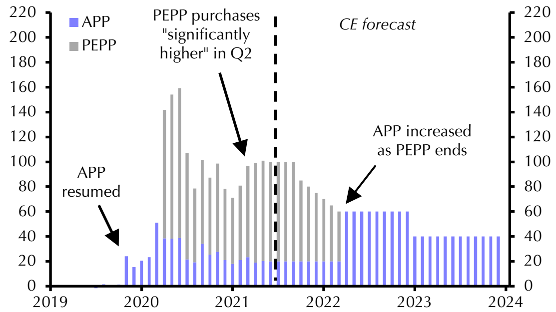
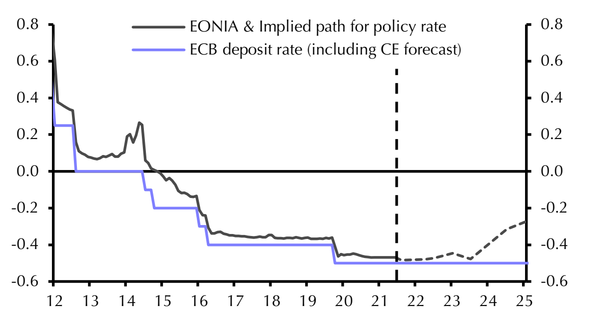


Chart 16: Deposit Rate & Forecasts (%)



Sources: Refinitiv, Markit, Capital Economics

Germany

First major economy back to normal

- **Germany will regain its pre-pandemic level of GDP earlier than other large euro-zone countries. Inflation will also rise further than elsewhere, but only temporarily.**

- After a poor start to the year, economic activity rebounded sharply in May. Most of the manufacturing sector (which was largely immune to the second lockdown) has regained its pre-pandemic level. Vehicle production has continued to struggle (see Chart 17) and will recover only slowly due to the semiconductor shortage.

- Household consumption is rebounding fast. Retail sales were quite resilient during the past year (see Chart 18) and spending on services is bouncing back after a sharp slump. Meanwhile, German export volumes have surged and will continue to benefit from strong growth in the rest of the world. All in all, strong demand should lift GDP to its pre-pandemic level this year. With long-term scarring likely to be modest, we expect the economy to then roughly follow its pre-pandemic path. (See Chart 19.)

- The labour market remains strong. The number of people on the *kurzarbeit* scheme has declined sharply and job vacancies have picked up. Also, surveys suggest that the unemployment rate will fall further in the coming months. (See Chart 20.)

- Inflation has already risen sharply in Germany and will remain higher than elsewhere because of the strength of the recovery as well as the impact of last year's temporary VAT cut. (See Chart 21.) Wage inflation, however, will remain subdued as multi-year negotiated wage settlements show continued pay restraint. (See Chart 22.)

- Germany's public finances are strong despite the pandemic. The general government deficit will be around 4% of GDP again this year before falling in 2022. (See Chart 23.) The recovery will lift tax revenues and emergency spending is wound down. The public debt-to-GDP ratio is still by far the lowest among G7 countries and should trend down again in the coming years.

- Support for the Greens has declined meaning that the CDU/CSU looks set to remain the largest group in parliament. (See Chart 24.) If the Greens are part of the coalition, the government may be more open to further EU integration. But whatever the outcome of September's general election, domestic macroeconomic policy will not change dramatically. The "debt brake" will not be re-imposed next year but is likely to be back in place from 2023.

Table 7: Key Forecasts (% y/y, unless stated)

	Ave. 10-19	2020	Forecasts 2021	2022	2023
GDP	2.0	-5.1	4.0	4.5	0.8
Private cons'ptn	1.5	-6.2	1.2	6.6	1.4
Total fixed invest.	2.9	-3.5	4.4	3.6	0.8
Gov't. cons'ptn	1.9	3.7	0.9	-0.8	0.0
Dom'stic demand	1.4	-4.3	2.9	4.2	1.0
Exports	4.8	-10.2	10.9	5.1	2.0
Imports	4.9	-9.0	9.1	4.7	2.4
Current account[1]	7.2	7.0	6.0	6.0	6.0
Headline Inflation	1.3	0.4	2.8	1.5	1.5
Core Inflation	0.8	0.6	2.3	1.8	1.5
Real disp income	1.5	0.0	0.0	0.8	0.5
H'hld sav. ratio[2]	10.2	16.3	12.3	9.5	9.8
Employment	1.0	-1.0	0.3	1.5	0.5
Unemp. rate[3]	4.7	3.9	3.8	3.5	3.5
Gen'l gov't bal.[1]	0.2	-4.2	-4.0	-1.0	0.0
Gen'l gov't debt[1]	73	70	69	66	64
10-yr. Gov. yield[4]	+0.98	-0.57	-0.25	0.00	+0.25

Sources: Refinitiv, Capital Economics
1) % of GDP, 2) % of disposable income, 3) % year avg., 4) % year-end.

Germany Charts

Chart 17: Industrial Production (Feb. 2020 = 100)

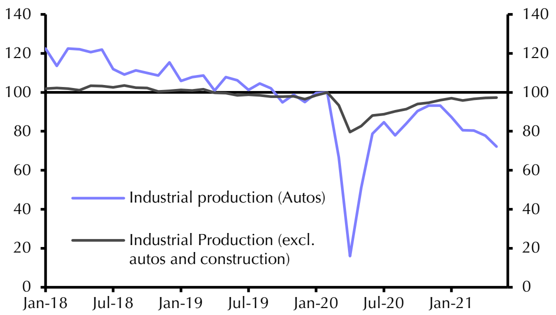


Chart 18: Retail Sales (Feb. 2020 = 100)

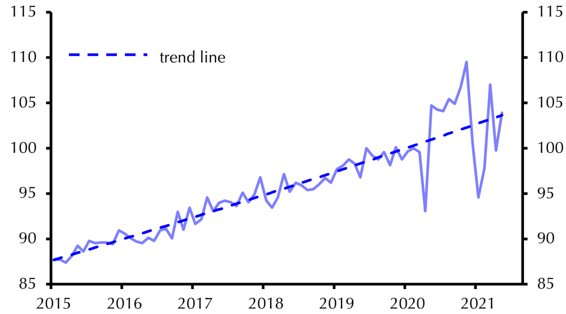


Chart 19: GDP (Q4 2019 = 100)

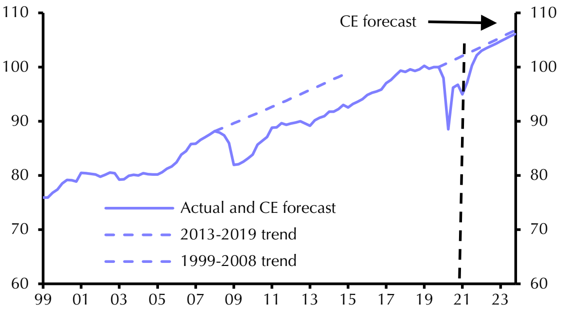


Chart 20: Unemployment Rate and IAB Barometer

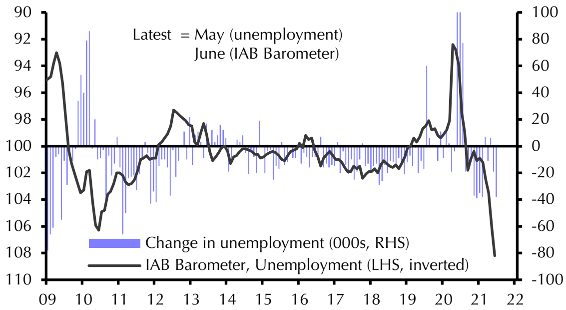


Chart 21: HICP Inflation (%)

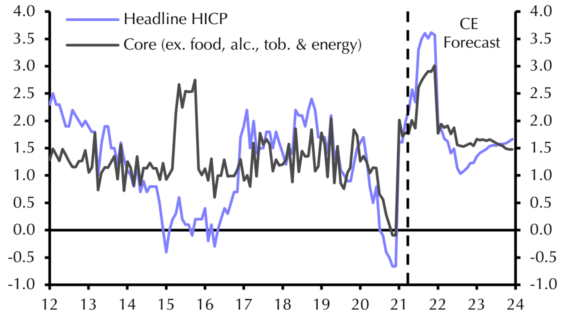


Chart 22: Wage Growth (% y/y)

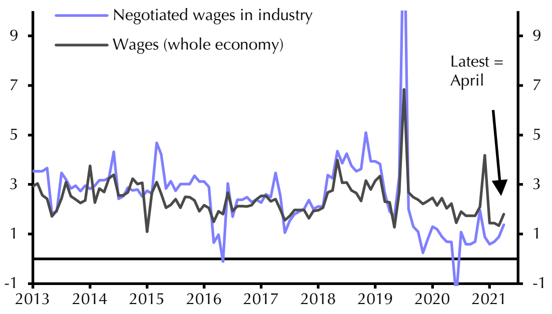


Chart 23: General Government Balance & Debt (% of GDP)

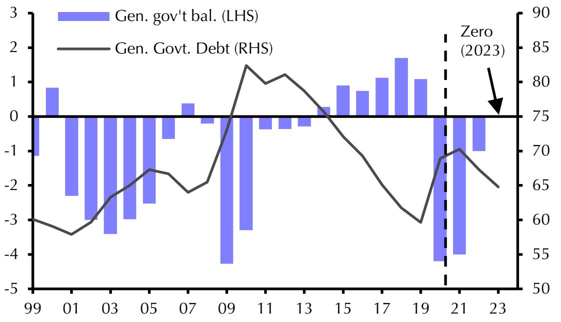
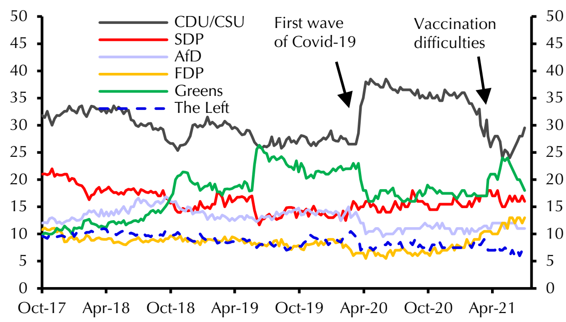


Chart 24: Voting Intentions (%, 2021 Elections)



Sources: Refinitiv, Markit, Capital Economics

France

Rapid recovery as 2022 elections come into view

- **France's economy is rebounding strongly from the third national lockdown in April. Support for jobs, and tax cuts for firms, will underpin the recovery. The biggest risk to our forecasts is a victory for Marine Le Pen in next year's presidential election.**

- The re-imposition of a national lockdown in April meant the economy started Q2 on the back foot, after contracting slightly in Q1. But mobility has shot up since restrictions were lifted in mid-May and is now close to its pre-pandemic level. (See Chart 25.) As a result, firms, especially in the services sector, estimate that economic activity has also increased. (See Chart 26.) The rebound in GDP in Q2 and especially Q3 looks set to be very strong.

- Consumer spending growth will be supported by improving conditions in the labour market. Although 2m people, or over 7% of the labour force, were on short-time work in May (see Chart 27), the tapering of the scheme from the start of June will encourage firms to bring workers back from furlough. And hiring activity in May was well above its pre-pandemic level. (See Chart 28.) This will support consumer spending growth.

- Meanwhile, firms' investment intentions have improved markedly over the past couple of quarters and point to very strong investment growth. (See Chart 29.) The government's France Relance programme, which includes cuts to firms' production taxes, should help to boost private and public sector investment too.

- Overall, we expect the sustained recovery now underway to allow GDP to return to its pre-pandemic level by Q4 this year and then to grow at a decent pace thereafter. By the end of 2023, our forecasts are for the economy to be only 1.5% smaller than if the pandemic had never happened. (See Chart 30.)

- France has been fairly generous with its fiscal support, but it is now starting to rein in its "whatever it costs" approach. We doubt that a premature return to austerity is on the cards though. As Chart 31 shows, the budget deficit will still be very large this year and much of the reduction in 2022 will be down to higher nominal GDP growth, not structural tightening.

- With the recovery underway, Macron had hoped to renew plans to reform the pension system. While these are needed, this would have been unpopular and a risky bet ahead of next year's election given the opinion polls. (See Chart 32.) A second term for Macron still looks most likely, but a Le Pen government cannot be ruled out. Frexit now appears to be off the table, but she would still set back France's reform efforts.

Table 8: Key Forecasts (% y/y, unless stated)

	Ave.		Forecasts		
	10-19	2020	2021	2022	2023
GDP	1.4	-8.0	6.3	3.8	1.3
Private cons'ptn	1.1	-7.2	4.3	5.4	1.9
Total fixed invest.	2.0	-8.9	9.6	3.8	2.2
Gov't. cons'ptn	1.2	-3.2	5.0	-0.2	-0.3
Dom'stic demand	1.5	-6.8	5.6	3.6	1.4
Exports	3.8	-16.1	9.2	5.5	3.1
Imports	4.1	-12.2	7.0	4.5	3.2
Current account(1)	-0.7	-2.3	-0.5	-0.3	-0.3
Headline Inflation	1.2	0.5	1.8	1.3	1.0
Core Inflation	0.9	0.6	1.3	1.0	1.0
Real disp income	0.9	0.5	1.8	1.8	1.3
H'hld sav. ratio(2)	14.5	21.5	19.8	17.0	16.3
Employment	0.6	-1.0	0.8	1.0	0.8
Unemp. rate (3)	9.6	8.0	8.0	7.5	7.5
Gen'l gov't bal.(1)	-4.1	-9.2	-9.0	-6.0	-4.5
Gen'l gov't debt(1)	94	116	116	116	116
10-yr. Gov. yield (4)	+1.50	-0.40	+0.10	+0.35	+0.60

Sources: Refinitiv, Capital Economics
1) % of GDP, 2) % of disposable income, 3) % year avg., 4) % year-end.

France Charts

Chart 25: Daily Trips Compared to Pre-Covid-19 Avg (%, 7-day Avg.)

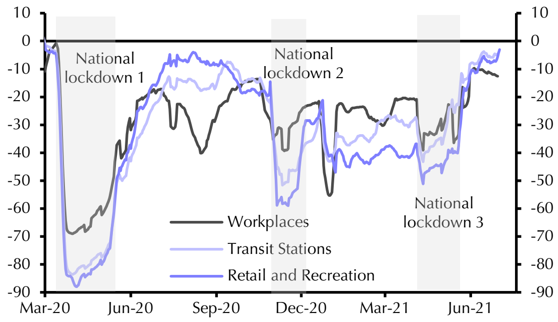


Chart 26: Firms' Estimates of Activity (% of Normal)

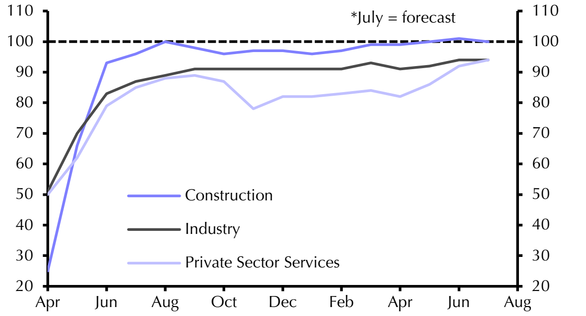


Chart 27: ST Work Beneficiaries (% of Labour Force)

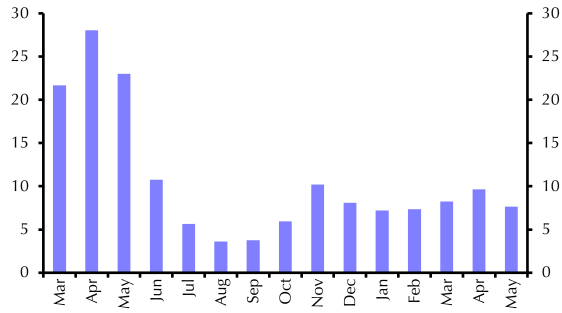


Chart 28: New Contracts Signed (February 2020 = 100)

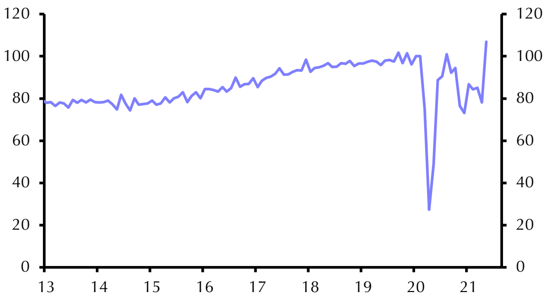


Chart 29: Firms' Investment Intentions & Investment

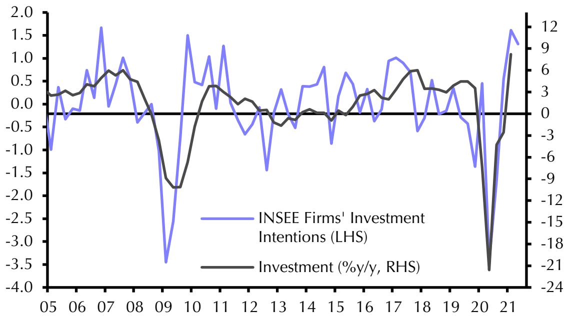


Chart 30: Real GDP (€bn)

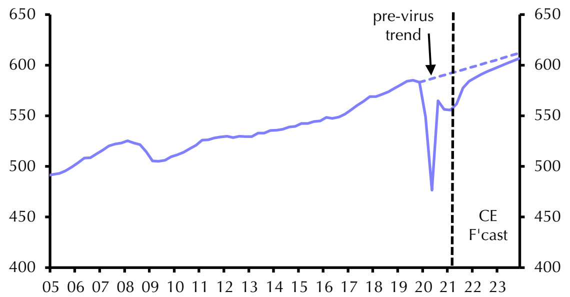


Chart 31: Headline Government Budget Balance (% of GDP)

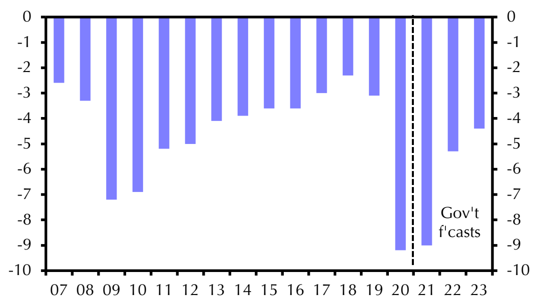
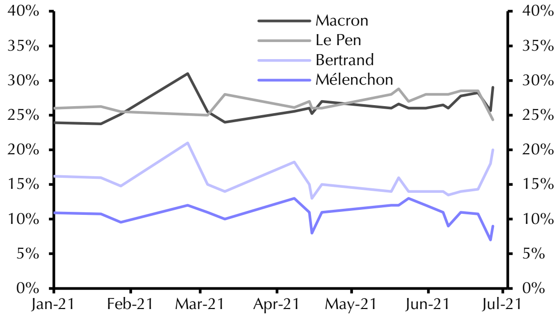


Chart 32: Voting Intentions for 1st Round of 2022 Presidential Election (%)



Sources: Refinitiv, BdF, Insee, Dares, JDD, Capital Economics

Italy

Strong rebound but slow trend growth

- **Italy looks set to rebound fairly quickly from the pandemic, but when its recovery is over it will revert to a slower trend rate of growth than the rest of the region. The public debt burden is high, but low interest rates mean that it should be sustainable.**

- Covid restrictions in Italy are now very light, with every region classified as a "white zone", the lowest of the four tiers. The easing of restrictions has come alongside a big increase in mobility. (See Chart 33.)

- Italy experienced a bigger drop in employment and incomes during the pandemic than most euro-zone countries, which suggests that it will also take longer to recover. That said, Italian households built up a large stock of savings last year that they could use to fund a spending binge. (See Chart 35.) This is an upside risk to our forecasts.

- Meanwhile, investment is already above its pre-pandemic level due to the strength of construction. Other forms of investment are still subdued. The near-term outlook is bright, with firms' assessment of the conditions for investment very high (see Chart 36), the banks generally in decent shape to make loans, and government-guaranteed credit still available. But even with activity rebounding quickly, spare capacity is likely to linger for some time. So after an initial surge, we suspect that investment growth will slow.

- Public investment will be supported by Next Generation EU. Disbursements to Italy are intended to begin at 1% of GDP this year and reach a peak of 2.5% by 2024 before falling again. (See Chart 37.) While that is a potentially a huge sum of money, we doubt that it will provide as much of a lasting boost as the government anticipates. There is a good chance that not all of the money will be spent, or spent well, and that accompanying reforms fall short.

- The government announced another support package in May, which included €40bn of fiscal measures and an extension of the loan moratorium until the end of the year. The budget deficit now looks likely to widen again this year to its highest level since the early 1990s. (See Chart 38.) Deep austerity is unlikely, but we assume that stimulus will be withdrawn over the next few years.

- The upshot of all this is that Italy's GDP is likely to grow more quickly than most expect this year and next. But beyond that the economy will revert to its potential growth rate of only a little more than zero, which is slower than many assume. While the debt ratio will fall only gradually (see Chart 39), persistently low bond yields should mean that debt servicing costs remain low too. (See Chart 40.)

Table 9: Key Forecasts (% y/y, unless stated)

	Ave. 10-19	2020	Forecasts 2021	2022	2023
GDP	0.3	-8.9	5.5	4.0	1.5
Private cons'ptn	0.1	-10.7	3.8	6.6	2.5
Total fixed invest.	-0.7	-9.2	12.2	0.3	0.3
Gov't cons'ptn	-0.6	1.6	1.4	-0.5	0.0
Dom'stic demand	-0.1	-8.4	5.3	3.9	1.6
Exports	3.8	-14.5	10.2	4.6	2.6
Imports	2.5	-13.1	10.2	4.2	2.8
Current account[1]	0.9	3.7	3.5	3.3	3.3
Headline inflation	1.3	-0.1	1.3	0.5	0.5
Core inflation	2.1	0.5	0.5	0.5	0.5
Real disp income	-0.3	-2.8	1.8	2.0	0.8
H'hld sav. ratio[2]	8.2	15.8	14.3	10.5	9.0
Employment	0.3	-2.8	-0.3	3.0	1.0
Unemp. rate (%)	10.9	9.3	10.3	9.8	9.5
Gen'l gov't bal.[1]	-2.8	-9.5	-11.0	-5.5	-3.5
Gen'l gov't debt[1]	131	156	157	155	155
10-yr gov't yield[3]	+3.14	+0.53	+0.75	+1.00	+1.25

Sources: Refinitiv, Capital Economics

1) % of GDP; 2) % of disposable income; 3) % year-end

Italy Charts

Chart 33: CE Lockdown Index & CE Mobility Tracker

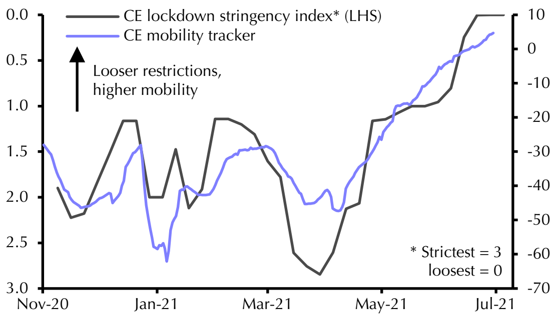


Chart 34: Household Disposable Incomes (% y/y)

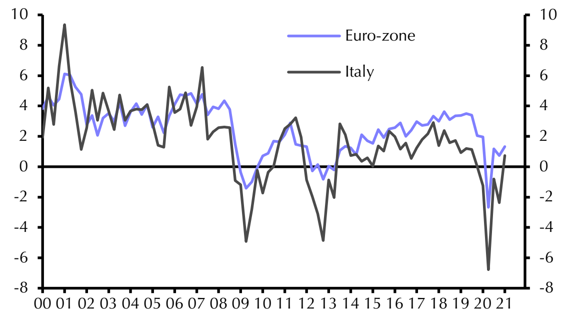


Chart 35: "Excess" Household Saving (Q1 2020 to Q1 2021, % of GDP)

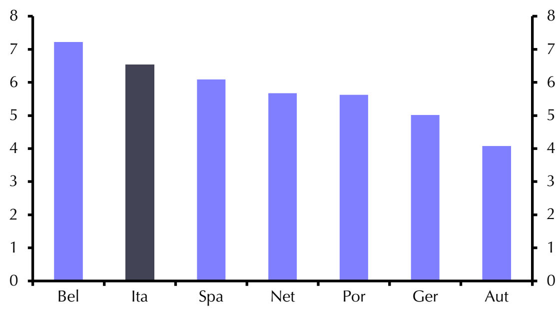


Chart 36: Machinery & Equipment Investment Firms' Assessment of Conditions for Investment

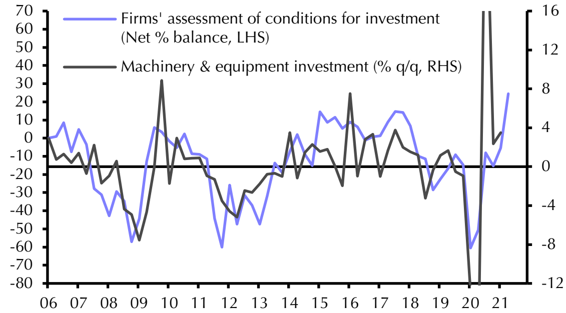


Chart 37: Planned Disbursements of Grants & Loans to Italy under Recovery & Resilience Facility (% of GDP)

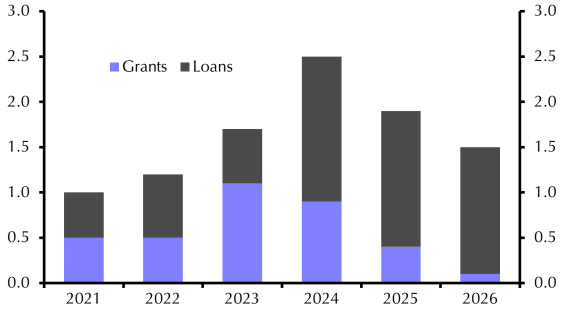


Chart 38: General Government Budget Balance (% of GDP)

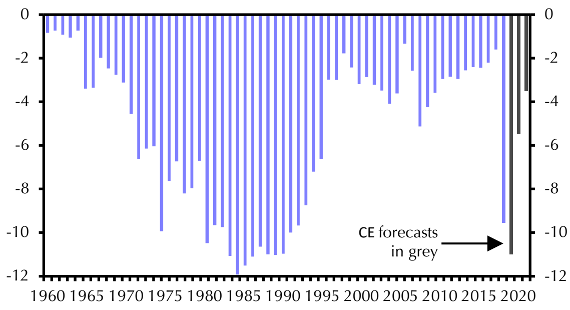


Chart 39: Gross Government Debt (% of GDP)

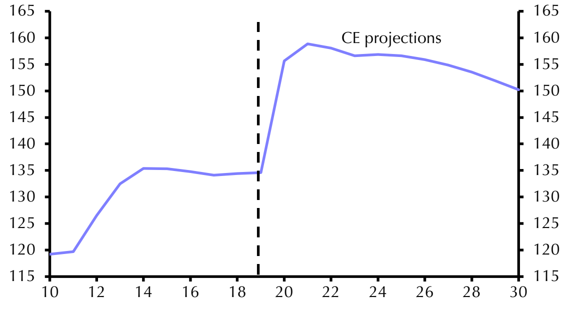
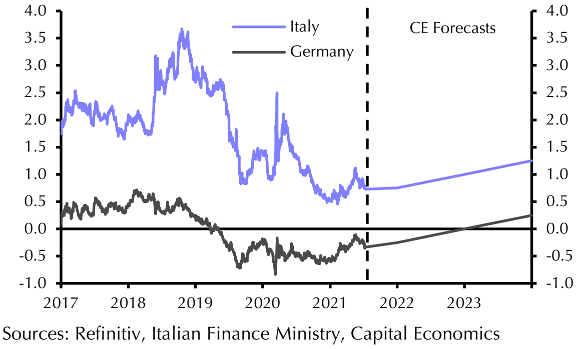


Chart 40: 10-year Government Bond Yields (%)



Sources: Refinitiv, Italian Finance Ministry, Capital Economics

Spain

Recovery held back by tourism uncertainty

- **The Delta variant and associated travel restrictions will cast a shadow over Spain's tourism season this year, but 2022 is likely to be more normal. The domestic economy is recovering too, but structural weaknesses will hinder the pace of growth in the medium term.**

- Spain's economy contracted by 0.4% q/q in Q1 but since then there has been a steady improvement in both people's mobility and business activity as the restrictions have been lifted. (See Chart 41.)

- While domestic activity has picked up, tourism remains depressed. The UK government has loosened travel rules (for now) but the recent surge in covid cases in Spain has caused some EU governments to advise against travel there. Card spending by foreigners is still well below 2019 levels. (See Chart 42.)

- So summer 2021 will still be far from normal and we expect foreign tourist spending to recover to only around half of 2019 levels this year. (See Chart 43.) By next summer, though, the tourism sector should be back to normal. Along with a domestic recovery, that will enable the overall economy to be back to pre-virus size by next summer. (See Chart 44.)

- Indeed, all the signs point to a healthy initial rebound in the domestic economy. There has been a strong recovery in employment since April (see Chart 45), and the jobless rate is now falling, a trend which we expect to continue over the coming year or two. (See Chart 46.) This will underpin strong growth in consumer spending. But there is still a reliance in Spain on temporary contracts, which ultimately will make workers more cautious about spending.

- Admittedly, the investment outlook is more mixed. While the pandemic has not sparked a financial crisis, banks are still wary of lending and firms are reluctant to borrow. But this partly reflects the cash buffers built up over the past year. What's more, leading indicators of investment are already back above or close to their February 2020 levels and point to further increases in investment. (See Chart 47.)

- As elsewhere, Spain's budget deficit has swelled during the pandemic. (See Chart 48.) Even so, the government has preferred where possible to use loan guarantees rather than direct aid, deferring the problem not solving it. Spain is set to be one of the biggest recipients of money from the EU's Recovery Fund, but political tensions within Spain continue to simmer and risk undermining the minority government's efforts to utilise EU funds effectively.

Table 10: Key Forecasts (% y/y, unless stated)

	Ave.		Forecasts		
	10-19	2020	2021	2022	2023
GDP	1.1	-10.8	5.5	6.5	2.5
Private cons'ptn	0.4	-12.4	7.5	7.4	2.3
Total fixed invest.	0.3	-11.4	4.7	6.4	3.8
Gov't. cons'ptn	0.3	3.8	1.8	-0.6	-0.1
Dom'stic demand	0.5	-9.0	5.5	5.4	2.1
Exports	4.7	-20.2	7.6	11.0	5.6
Imports	2.6	-15.8	8.0	7.2	4.7
Current account[1]	0.9	0.7	-0.3	-0.3	0.3
Headline Inflation	1.1	-0.3	2.3	1.0	0.8
Core Inflation	2.7	2.5	0.5	0.8	0.8
Real disp income	-0.1	-3.3	3.0	4.3	2.5
H'hld sav. ratio[2]	7.2	14.8	10.0	8.0	7.0
Employment	0.2	-4.3	2.8	2.3	1.5
Unemp. rate [3]	20.5	15.5	15.3	14.5	13.8
Gen'l gov't bal.[1]	-6.1	-11.0	-9.0	-7.5	-5.0
Gen'l gov't debt[1]	90	120	120	119	117
10-yr. Gov. yield [4]	+2.85	+0.06	+0.40	+0.65	+0.90

Sources: Refinitiv, Capital Economics
1) % of GDP, 2) % of disposable income, 3) % year avg., 4) % year-end.

Spain Charts

Chart 41: Composite PMI & Google Mobility Indicator

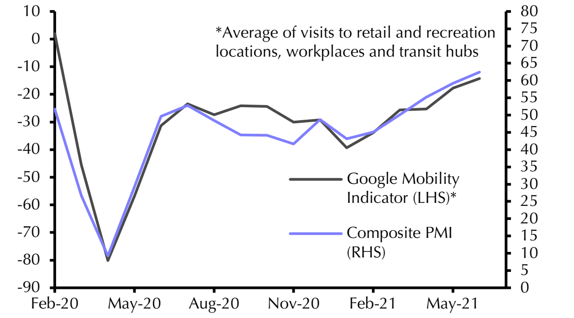


Chart 42: Tourism Spending (% change from 2019)

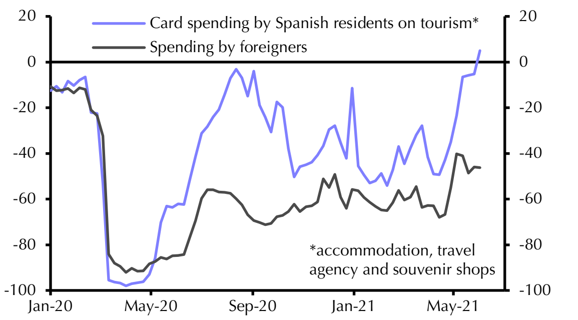


Chart 43: Foreign Tourist Expenditure (€mns)

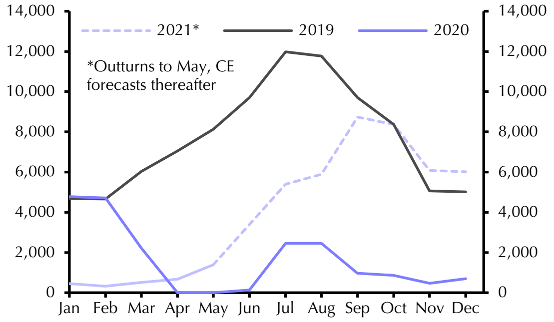


Chart 44: GDP (Q4 2019 = 100)

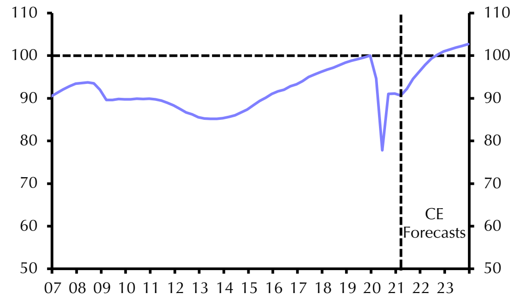


Chart 45: Registered Employment (7-day MA, mns)

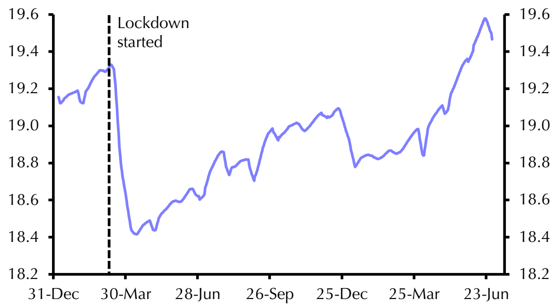


Chart 46: Unemployment Rate (%)

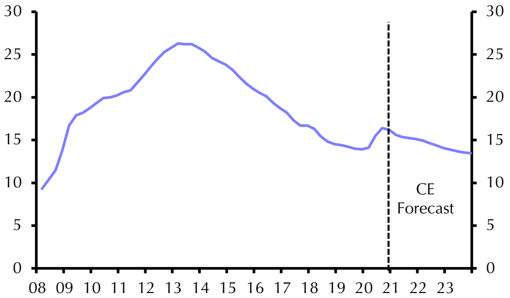


Chart 47: Capital Goods Imports, Reg. of Goods Vehicles & Machinery Inv't (Q4 '19/Feb.20 = 100)

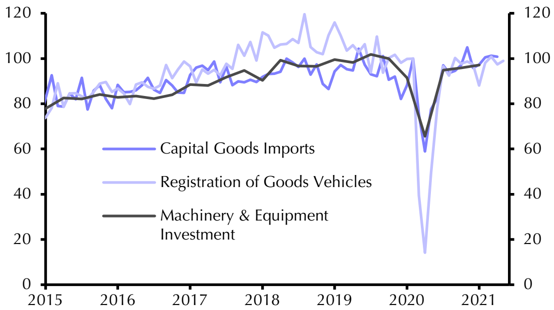
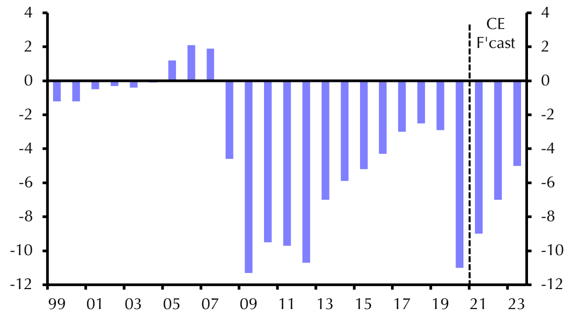


Chart 48: Spain General Government Budget Balance (% of GDP)



Sources: Refinitiv, Markit, Google, Caixabank, Spain Labour Ministry, CE

Netherlands

Well positioned for decent growth

- **The Netherlands' economy is set to regain its pre-virus size by the end of the summer and is well placed for a healthy recovery.**

- After contracting in Q1, the Dutch economy is likely to grow rapidly in Q2 and Q3, following the lifting of restrictions. While the recent rise in new infections has caused the authorities to re-impose some restrictions, they will have only a limited effect on the economy. Industrial confidence has soared and points to a rapid pick-up in GDP growth. (See Chart 49.) Indeed, the economy is on course to be back to its Q4 2019 size by the end of Q3.

- Barring the emergence of new vaccine-resistant variants, the economy should continue to grow strongly. Thanks in part to a generous short-time work scheme, disposable income rose sharply last year. So consumers are in a strong position, even as higher inflation eats into their purchasing power this year.

- Admittedly, Brexit remains a drag on trade. But exports should hold up amid a recovery in the world economy and trade flows. Moreover, the resilience of the housing market points to stronger dwellings investment to come. (See Chart 50.) And while the fall in bankruptcies over the past year will probably be reversed (see Chart 51), government support for firms means that we are unlikely to see a surge in company failures that would act as a drag on business investment.

- The government extended its emergency support package for businesses until September, so fiscal policy will remain expansionary this year. Next year, the budget deficit will narrow as state support is wound down. There is a risk that the Dutch expect other harder-hit euro-zone economies to do the same.

Chart 49: CBS Industrial Confidence & GDP

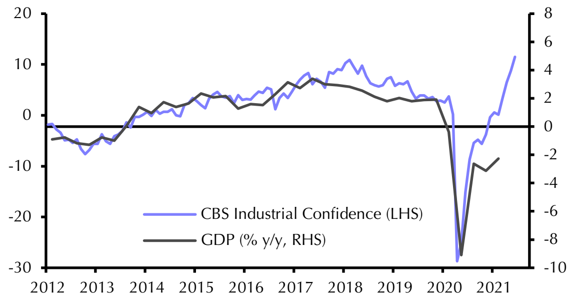


Chart 50: House Sales & Dwellings Investment

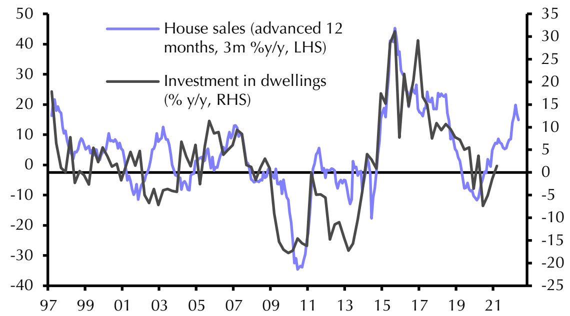
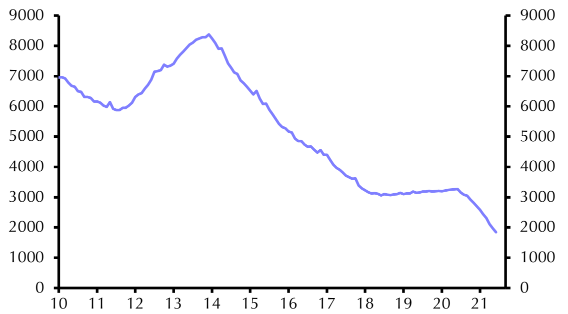


Chart 51: Company Bankruptcies (12-month Sum)



Sources: Refinitiv, Eurostat, CBS

Table 11: Key Forecasts (% y/y, unless stated)

	Ave.		Forecasts		
	10-19	2020	2021	2022	2023
GDP	1.4	-3.8	3.8	4.5	2.3
Private cons'ptn	0.7	-6.6	1.9	6.7	2.4
Total fixed invest.	-0.8	-4.2	6.2	3.0	2.4
Net trade effect	0.2	2.8	0.9	0.2	-0.7
Unemp. rate[1]	5.6	3.8	3.3	3.0	3.0
HICP	1.3	1.1	2.3	1.8	1.5
Gen'l gov't bal.[2]	-1.6	-4.3	-4.0	-2.5	-2.0
Gen'l gov't debt[2]	61	55	55	55	52
Current account[2]	9.0	7.8	8.0	9.0	9.0

Sources: Refinitiv, Eurostat, CE. 1) % year avg., 2) % of GDP.

Portugal

Recovery blunted by weak tourist season

- **The easing of Covid restrictions has allowed Portugal to begin a consumer-led recovery. But with a weak tourist season this year, we expect the recovery to lag behind those of other euro-zone countries.**

- Portugal experienced another significant contraction in economic activity in Q1, as lockdown measures were reinstated to combat a third wave of infections. But after progressively easing restrictions since March, economic activity will have rebounded in Q2. High frequency data point to a rapid increase in consumption (See Chart 52.).

- Nevertheless, the spread of the Delta variant and the continuation of travel restrictions mean the country is going to experience another weak tourist season. As Portugal is even more reliant than Spain on tourism, this will constrain the recovery significantly. We think tourism will rebound from 45% of its 2019 level in 2020 to slightly over half of 2019 levels this year. (See Chart 53.)

- Throughout the pandemic, the government has provided state-backed credit to help businesses. But with the easing of restrictions and government support being tapered, companies' demand for credit is falling, which in the past has been associated with a fall in investment. (See Chart 54.)

- The European Commission has recently approved Portugal's Recovery and Resilience Plan, which amounts to €16.6bn (approximately 6% of GDP) spread over the next five years. Because most of the funds will not be spent immediately, it will only have a small impact on GDP this year and next. But if all of the money is spent, and spent well, it could provide a significant boost to demand.

Chart 52: Daily Retail & Recreation Trips Compared to Pre-Covid 19 Avg (% 7-day Avg)

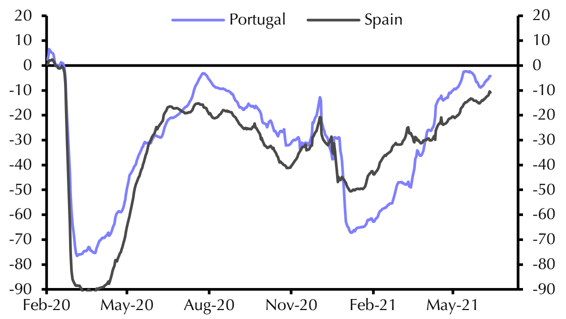


Chart 53: Tourism Expenditure (Travel Services Exports in Balance of Payments, €bn)

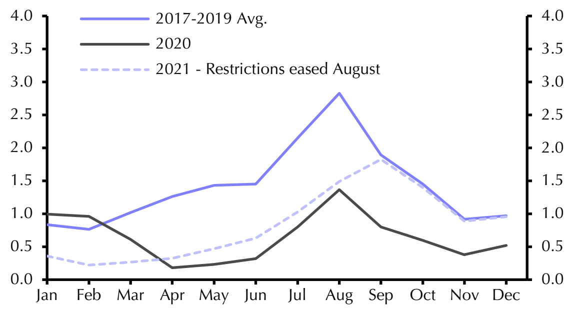
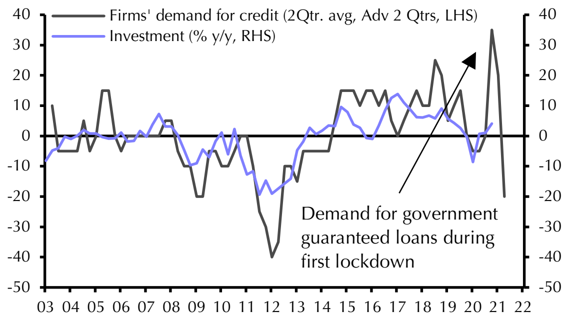


Chart 54: Investment and Firms' Demand for Credit



Sources: Refinitiv, Statistics Portugal, Google, CE.

Table 12: Key Forecasts (% y/y, unless stated)

	Ave.		Forecasts		
	10-19	2020	2021	2022	2023
GDP	0.9	-7.6	2.3	5.5	2.5
Private cons'ptn	0.6	-6.0	2.4	6.4	2.2
Total fixed invest.	-0.1	-1.8	7.1	3.1	2.2
Net trade effect	0.6	-3.0	-1.3	0.9	0.6
Unemp. rate[1]	12.2	7.1	7.0	6.8	6.5
HICP	1.1	-0.1	0.5	0.5	0.3
Gen'l gov't bal.[2]	-4.7	-5.7	-5.0	-2.0	-1.5
Gen'l gov't debt[2]	124	134	135	129	126
Current account[2]	-1.2	-1.2	-0.5	0.3	0.5

Sources: Refinitiv, Markit, CE. 1) % year avg., 2) % of GDP.

Greece

Tourism shortfall weighing on recovery

- **The Greek economy is unlikely to regain its pre-pandemic level this year because the tourist season will be very weak. However, the continued support of the ECB will keep a lid on sovereign bond yields.**

- Greece has been hit hard by the pandemic, but not quite as severely as the Spanish or Portuguese economies. And it is now experiencing a strong recovery: after posting a 4.4% q/q increase in GDP in Q1 we expect the economy to expand further in the summer.

- Retail sales jumped by 10% m/m in April to roughly the same level as they were before the pandemic 2019. The (relatively small) industrial sector has rebounded too. (See Chart 55.)

- However, tourist numbers are well below normal. Passenger arrivals at Athens airport picked up in May and June but only to around 40% of their 2019 levels. (See Chart 56.) We are forecasting a full recovery next year, based on our assumption that the pandemic is brought under control. That said, there has been a sharp increase in the number of new Covid cases in Greece in the past two weeks.

- Greece is one of the biggest beneficiaries of EU grants. (See Chart 57.) However, they are no panacea especially given that governments have in the past failed to use all the funds allocated in the EU budget due to slow procurement and project implementation.

- While the public debt burden is among the highest in the world, debt servicing costs will be manageable because Greek bonds are included in ECB's emergency asset purchase programme (PEPP). When the PEPP is wound down, we expect the ECB to continue purchasing Greek bonds through its regular asset purchase programme.

Chart 55: Industrial Production & Confidence

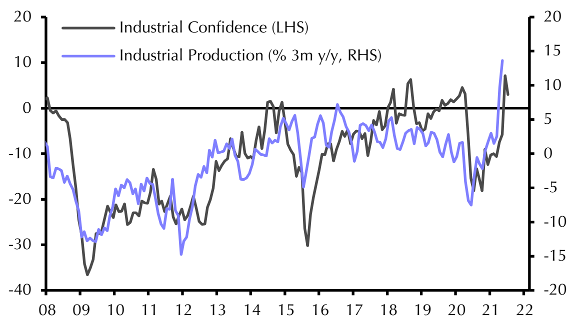


Chart 56: Air Passengers and Tourism Spending (% of 2019)

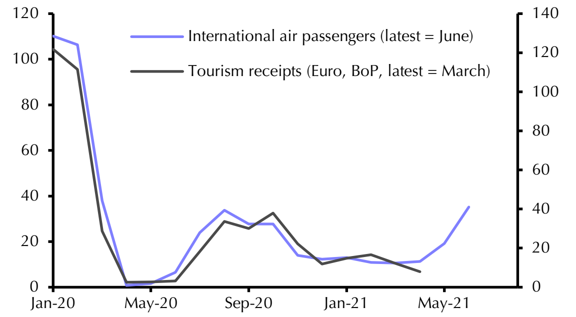
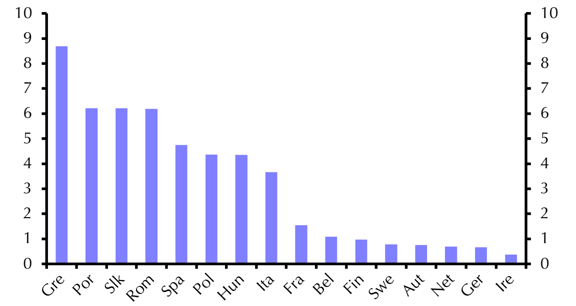


Chart 57: Resilience & Recovery Facility Total Grants Allocation (% of GDP)



Sources: Refinitiv, AIA, EC, Google, Apple, Moovit, CE

Table 13: Key Forecasts (% y/y, unless stated)

	Ave. 10-19	2020	Forecasts 2021	2022	2023
GDP	-2.1	-8.2	8.0	2.0	1.3
Private cons'ptn	0.0	-4.8	1.2	2.9	1.4
Total fixed invest.	0.0	0.8	5.8	1.9	1.3
Net trade effect	0.6	-4.3	0.5	0.4	0.0
Unemp. rate[1]	21.6	16.4	16.3	15.8	14.8
HICP	0.9	-1.3	0.3	0.5	0.5
Gen'l gov't bal.[2]	-5.1	-9.7	-8.0	-3.5	-2.5
Gen'l gov't debt[2]	175	206	198	196	195
Current account[2]	-3.3	-6.7	-2.0	-4.0	-4.0

Sources: Refinitiv, Capital Economics. 1) % year avg., 2) % of GDP.

Ireland

Brexit disruption won't stop GDP from growing strongly

- **We expect the Irish economy to remain an outperformer, despite Brexit and plans for global corporate tax reform.**

- In contrast to the rest of the euro-zone, Ireland's GDP rose last year, in large part due to pharmaceuticals (part of manufacturing) and computer services exports. The early data for this year suggest that pharma and IT exports will continue to do well. Brexit has been a drag on Ireland's international trade, but goods and services exports were still very strong in Q1 (see Chart 58) and look set to keep rising.

- The stage is now set for a rapid recovery in domestic demand. Generous fiscal support helped households increase their incomes last year, while they have also run up large stocks of savings. (See Chart 59.) And with timely data showing that restaurant bookings are now about 60% above 2019 levels, it seems consumers are keen to spend. So the outlook for household consumption is bright.

- What's more, while investment is very volatile due to the activity of multinationals, making it difficult to predict, after dropping sharply in Q1 it will probably rise over the rest of the year.

- Admittedly, plans for a minimum global corporate tax rate are a risk to foreign investment and could lead to lower tax revenues. But low tax isn't the only reason for Ireland's economic success, and both the US and UK plan to hike their tax rates further above the minimum. (See Chart 60.) So an increase from 12.5% to 15.0% in Ireland would not radically alter the economic outlook.

- The upshot is that we think Ireland will post very strong GDP growth in the next few years. That would help to bring the public debt ratio back down from its already fairly low level.

Chart 58: Export Volumes (Q4 2019 = 100)

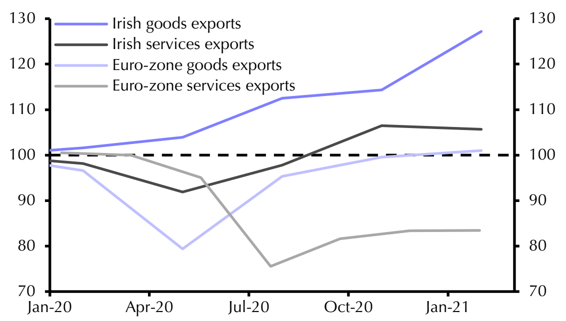


Chart 59: Household Saving Rate (%)

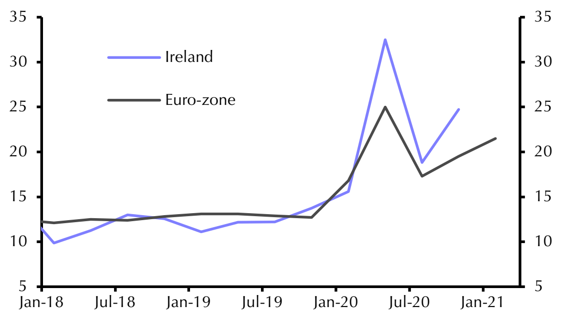
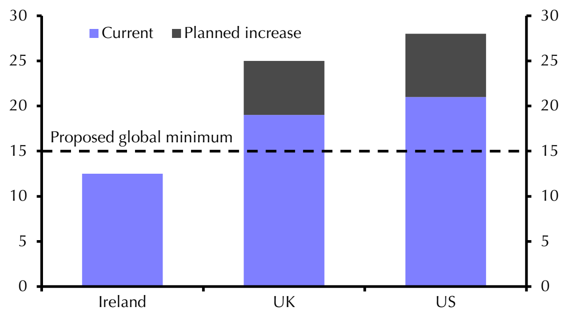


Chart 60: Corporate Tax Rates (%)



Sources: Refinitiv, Capital Economics

`Table 14: Key Forecasts (% y/y, unless stated)

	Ave.		Forecasts		
	10-19	2020	2021	2022	2023
GDP	6.4	2.5	7.0	3.5	2.5
Private cons'ptn	1.7	-9.1	6.4	8.2	1.7
Total fixed invest.	17.8	-32.3	-22.4	14.7	3.0
Net trade effect	1.4	20.6	14.6	-5.4	0.1
Unemp. rate[1]	10.7	5.8	8.5	8.3	6.4
HICP	0.4	-0.5	1.5	1.0	0.5
Gen'l gov't bal.[2]	-6.5	-5.0	-4.0	-2.0	-1.5
Gen'l gov't debt[2]	88	60	59	58	57
Current account[2]	-0.8	4.6	11.0	6.5	7.0

Sources: Refinitiv, Eurostat, CSO, CE. 1) % year avg., 2) % of GDP.

Other Euro-zone

Finland still outperforming

- **Both Belgium's and Austria's economies are likely to recover strongly thanks to generous fiscal support boosting consumption and investment. But it is Finland which has been most successful at limiting the damage from lockdowns and GDP growth there is set to return sooner than most to its pre-virus trend.**

- **Belgium**'s economy was one of the few in the region to have grown in Q1, expanding by 1% q/q. Business surveys point to further increases in Q2 and Q3. (See Chart 61.) Growth in disposable income in 2020 will provide some support consumer spending growth this year, but higher inflation will eat into their incomes.

- Government support for firms is set to continue, partly financed by the Recovery Fund. This should ensure that business and public investment will grow strongly over the next couple of years. Meanwhile, Belgium's recovery is less dependent on the return of tourism than most European countries. And the broader global recovery should support Belgian goods exports. (See Chart 62.)

- Since the pandemic began, **Austria**'s government has provided fiscal support worth nearly 12% of GDP, which is among the largest amounts of stimulus in the euro-zone. That should help domestic demand to recover quickly now that most restrictions have been lifted. The budget deficit is likely to remain wide this year before falling sharply in 2022. (See Chart 63.) Next Generation EU will provide less ongoing fiscal stimulus than in most other countries.

- Austria's exports will remain closely tied to the German economy, which we expect to grow relatively quickly. (See Chart 64.) But lower tourism numbers, both in summer and perhaps in the winter ski season (see Chart 65), mean that Austria will lag slightly behind its larger neighbour.

- **Finland** has controlled the virus better than any major euro-zone economy, while its relatively large manufacturing sector and small tourism sector mean that lockdowns caused less damage. Monthly data for April show that GDP was just 0.7% below its pre-pandemic level. And the timelier surveys have strengthened further, suggesting that the economy will quickly return to around its pre-crisis trend.

- Employment shot up in May and the surveys point to further improvements. (See Chart 66.) With household incomes having risen last year, the outlook for consumption is bright. Admittedly, fiscal support will be scaled back (see Chart 67) and Finland will receive relatively little from Next Generation EU. But external demand should grow strongly. We expect Finnish GDP to return to its end-2019 level by Q3 2021, ahead of many other euro-zone economies (see Chart 68), and to continue growing at a decent pace thereafter.

Table 15: Key Forecasts (% y/y, unless stated)

	Ave. 10-19	2020	Forecasts 2021	2022	2023
GDP					
Belgium	1.6	-6.3	5.8	3.5	2.8
Austria	1.6	-6.4	3.5	5.5	0.8
Finland	1.2	-2.7	2.5	2.8	1.5
Slovakia	3.0	-4.8	4.8	5.5	4.0
Slovenia	1.9	-5.5	6.0	2.8	1.5
Luxembourg	3.1	-1.3	4.8	3.0	3.0
Cyprus	1.4	-5.1	4.8	2.5	2.3
Headline consumer prices					
Belgium	1.7	0.4	2.0	1.6	1.3
Austria	1.8	1.4	2.5	2.0	1.5
Finland	1.5	0.4	1.8	1.3	1.0
Slovakia	1.6	2.0	1.8	2.0	2.0
Slovenia	1.4	-0.3	1.5	1.0	0.8
Luxembourg	1.8	0.0	2.5	2.0	1.5
Cyprus	0.9	-1.1	1.5	1.3	1.0

Sources: Refinitiv, Capital Economics

Other Euro-zone Charts

Chart 61: Belgian Business Confidence & GDP

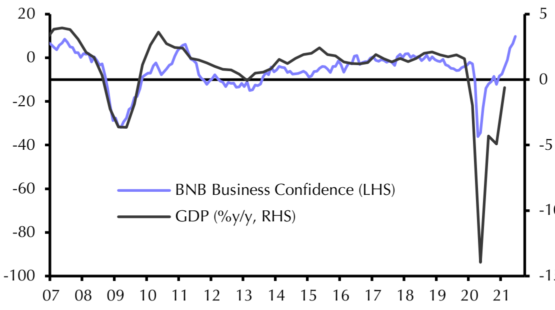


Chart 62: Belgium Exports & Weighted Average of Foreign Demand

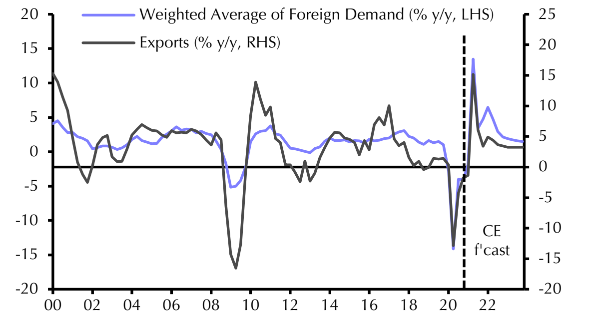


Chart 63: Austria's Budget Balance (% of GDP)

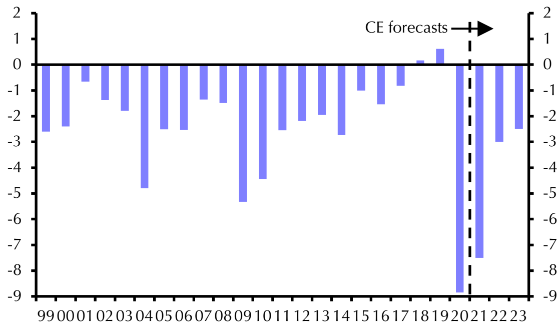


Chart 64: German GDP & Austrian Exports (% y/y)

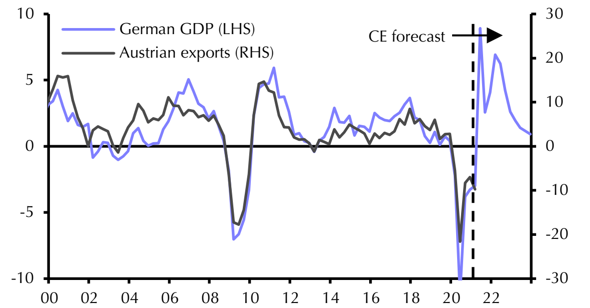


Chart 65: Nights Spent at Austrian Tourist Accommodation (mn)

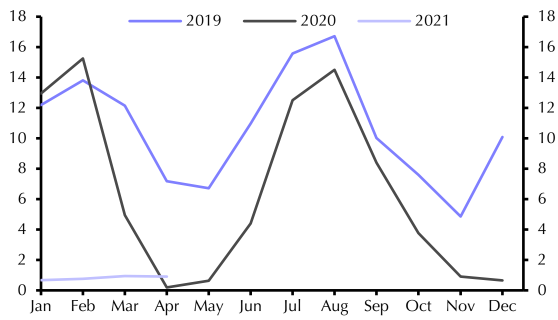


Chart 66: Finland Employment & Hiring Expectations

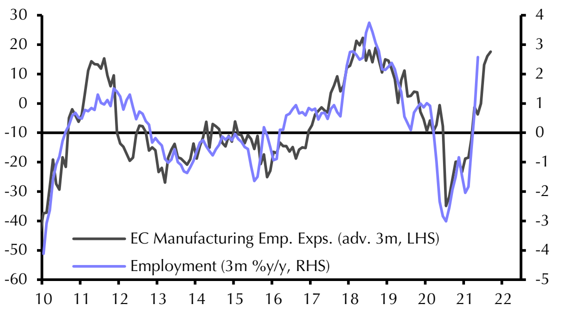


Chart 67: Finland General Government Budget Balance (% of GDP)

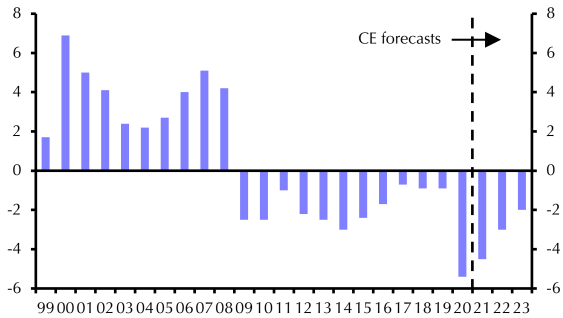
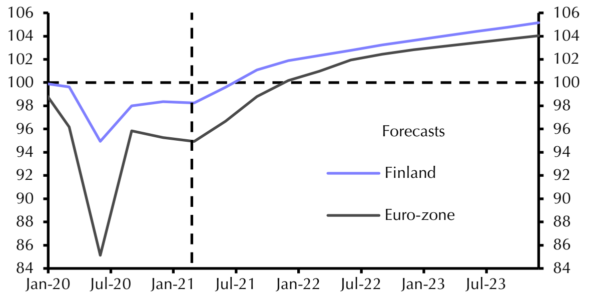


Chart 68: GDP (Q4 2019 = 100)



Sources: Refinitiv, Capital Economics

Long-term Outlook

Pandemic to cause less lasting damage than previous crises

- **We expect the pandemic to result in less permanent economic scarring than previous crises. The ECB's strategy review doesn't change our view that it will take a long time for inflation to hit 2% on a sustained basis. So the Bank will need to keep interest rates low for a very long time and maintain a large stock of government bond holdings.**

- There should be less permanent "scarring" than after past crises. After all, policy support has been much greater than in 2008/09, preventing banking and sovereign debt crises, and premature tightening seems unlikely. Private sector deleveraging will also be less of a drag. And there aren't huge imbalances that need to be corrected. So we assume that the economy will eventually recoup most of the shortfall in output (see Chart 77) and return to its potential growth rate of just over 1%.

- There are long-term upside risks to inflation in advanced economies. Some of the forces that have kept inflation low across advanced economies in recent decades, such as globalisation, could go into reverse. Central banks in a number of countries, most obviously the US, have shown greater tolerance for inflation. And the ECB's new inflation target gives it scope to leave policy loose for longer.

- However, the upside risks to inflation are smaller in the euro-zone than elsewhere. In the grand scheme of things, the new symmetric 2% target is not a long way above the old one, and the Bank appears to have far less tolerance for inflation overshoots than the Fed.

- What's more, the Bank won't get much help from other policymakers in raising demand and inflation. The EU is likely to re-impose some form of fiscal rules, so tax and spending policy won't be as persistently expansionary as elsewhere. And core euro-zone countries do not appear to have changed their views on the need for balanced budgets in normal times.

- Accordingly, we think that inflation in the euro-zone will increase only very gradually in the long-term and stay below that in the US (see Chart 78) and most other developed economies apart from Japan.

- With inflation set to remain below target for a long time, we think the ECB will leave interest rates unchanged until the second half of the decade. (See Chart 79.) And while the Bank looks set end net purchases under the PEPP next year, it is likely to maintain its PEPP holdings for a long time. And it will need to carry on purchasing assets under the APP for many more years. Its current guidance says that these purchases will continue until shortly before it raises interest rates.

- If we are right that interest rates will remain extremely low, and that the ECB will maintain a significant presence in the bond markets, then yields will increase only very slowly. (See Chart 80.) In turn, this dramatically reduces the chance of another debt crisis. But that's not to say that the euro-zone's structural problems have all been solved. Its banking sector is fragmented along national lines, it lacks a permanent euro-zone budget, and a one-size-fits-all monetary policy is not ideal.

- Meanwhile, the German and French economies look likely to pull away from their Italian and Spanish counterparts. Both Italy and Spain have pre-existing productivity problems and poor demographic outlooks. We doubt that these will be resolved by Next Generation EU. This divergence poses one of the key challenges for euro-zone policymakers in the long term.

Long-term Outlook Charts

Chart 69: Euro-zone Real GDP (€bn)

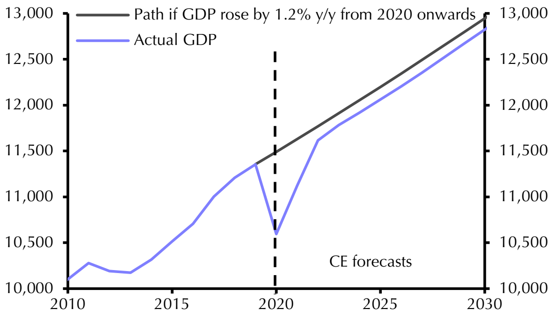


Chart 70: Consumer Prices (% y/y)

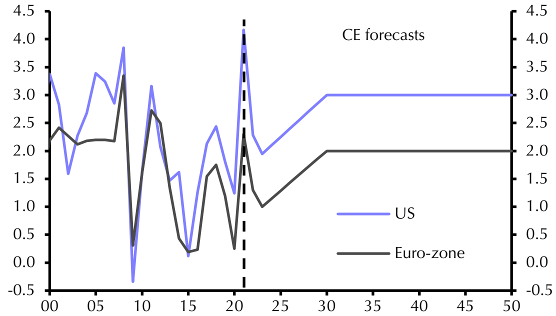


Chart 71: ECB Policy Rates (%)

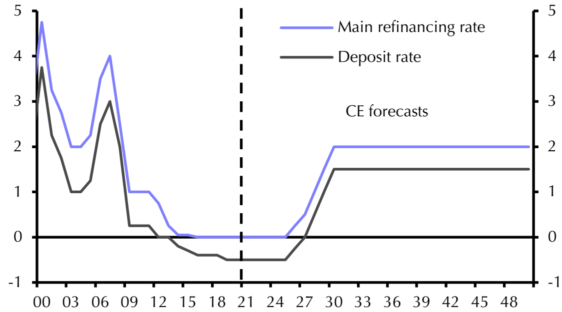
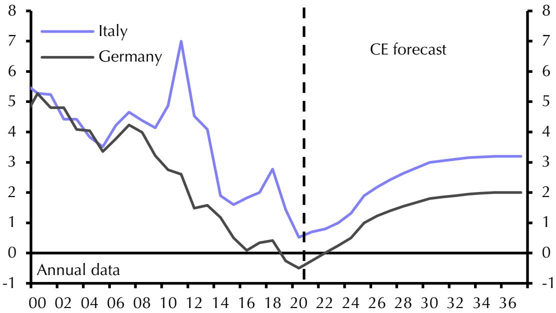


Chart 72: 10-year Government Bond Yields (%)



Sources: Refinitiv, Capital Economics

Table 17: Key Forecasts (% y/y, Averages, unless otherwise stated)

	2006-2010	2011-2015	2016-2020	2021-2025	2026-2030	2031-2050
Real gross domestic product	0.8	0.8	0.2	2.6	1.2	1.1
Private consumption	0.8	0.2	-0.3	2.8	1.2	1.1
Productivity	0.4	0.6	-0.6	1.9	1.4	1.6
Employment	0.4	0.2	0.8	0.8	-0.2	-0.5
Unemployment rate (%)	10.2	10.9	7.9	6.8	7.0	7.0
Average monthly earnings	2.2	1.6	2.2	1.9	3.2	3.6
Harmonised index of consumer prices	1.9	1.4	1.0	1.3	1.7	2.0
ECB deposit rate (%)[1]	0.3	-0.3	-0.5	-0.5	1.5	1.5
Government budget balance (% of GDP)	-3.4	-3.1	-2.4	-3.1	-1.6	-1.9
Government debt (% of GDP)	85.8	90.9	97.2	91.8	86.8	76.9
Current account balance (% of GDP)	-0.5	1.6	2.9	3.0	3.3	3.1
USD to EUR[1]	1.34	1.09	1.22	1.23	1.33	1.56
Nominal gross domestic product (US$ bn)	12,773	11,423	13,848	16,759	21,172	45,719
Population (mn)	336.2	339.5	340.9	340.7	339.6	327.8

1) End of period

Detailed Forecasts – GDP & Inflation

Table 18: Real GDP

% y/y	Average 08-17	2018	2019	2020	2021f	2022f	2023f
Germany	1.3	1.3	0.6	-5.1	4.0	4.5	0.8
France	0.8	1.8	1.8	-8.0	6.3	3.8	1.3
Italy	-0.5	0.8	0.3	-8.9	5.5	4.0	1.5
Spain	0.3	2.4	2.0	-10.8	5.5	6.5	2.5
Netherlands	0.9	2.3	1.9	-3.8	3.8	4.5	2.3
Belgium	1.1	1.8	1.8	-6.3	5.8	3.5	2.8
Austria	1.0	2.5	1.4	-6.4	3.5	5.5	0.8
Ireland	3.9	8.9	5.9	2.5	7.0	3.5	2.5
Greece	-2.9	1.6	1.9	-8.2	8.0	2.0	1.3
Portugal	0.0	2.8	2.5	-7.6	2.3	5.5	2.5
Finland	0.2	1.3	1.3	-2.7	2.5	2.8	1.5
Slovakia	2.4	3.7	2.3	-4.8	4.8	5.5	4.0
Slovenia	0.7	4.4	3.2	-5.5	6.0	2.8	1.5
Luxembourg	2.0	3.1	2.3	-1.3	4.8	3.0	3.0
Cyprus	0.7	5.2	3.1	-5.1	4.8	2.5	2.3
Euro-zone	**0.7**	**1.9**	**1.3**	**-6.7**	**5.0**	**4.5**	**1.5**
Sweden	1.7	2.0	2.0	-2.9	4.0	3.0	2.0
Denmark	0.9	2.0	2.1	-2.1	3.5	3.5	2.0
EU (27)	**0.8**	**2.1**	**1.6**	**-6.2**	**4.9**	**4.4**	**1.5**
UK	1.1	1.3	1.4	-9.8	8.0	5.5	2.5
Switzerland	1.7	3.0	1.1	-2.7	4.0	3.5	2.0
Norway*	1.6	2.5	2.4	-3.1	4.0	4.0	2.0
US	1.5	3.0	2.2	-3.5	6.0	3.5	2.5
Japan	0.5	0.6	0.0	-4.7	2.8	3.0	1.7

Source: Refinitiv, Capital Economics. *Mainland GDP

Table 19: Consumer Prices (HICP)

% y/y	Average 08-17	2018	2019	2020	2021f	2022f	2023f
Germany	1.4	1.9	1.4	0.4	2.8	1.5	1.5
France	1.3	2.1	1.3	0.5	1.8	1.3	1.0
Italy	1.5	1.3	0.6	-0.1	1.3	0.5	0.5
Spain	1.4	1.7	0.8	-0.3	2.3	1.0	0.8
Netherlands	1.4	1.6	2.7	1.1	2.3	1.8	1.5
Belgium	1.9	2.3	1.3	0.4	2.0	1.6	1.3
Austria	1.9	2.1	1.5	1.4	2.5	2.0	1.5
Ireland	0.4	0.7	0.9	-0.5	1.5	1.0	0.5
Greece	1.2	0.8	0.5	-1.3	0.3	0.5	0.5
Portugal	1.2	1.2	0.3	-0.1	0.5	0.5	0.3
Finland	1.8	1.2	1.1	0.4	1.8	1.3	1.0
Slovakia	1.5	2.5	2.8	2.0	1.8	2.0	2.0
Slovenia	1.6	1.9	1.7	-0.3	1.5	1.0	0.8
Luxembourg	1.8	2.0	1.6	0.0	2.5	2.0	1.5
Cyprus	1.2	0.8	0.6	-1.1	1.5	1.3	1.0
Euro-zone	**1.4**	**1.8**	**1.2**	**0.3**	**2.3**	**1.3**	**1.0**
Sweden*	1.4	2.1	1.7	0.5	1.7	1.2	1.3
Denmark	1.4	0.7	0.7	0.4	1.5	0.8	0.5
EU (27)	**1.5**	**1.8**	**1.4**	**0.7**	**2.2**	**1.2**	**1.0**
UK*	2.4	2.5	1.8	1.0	2.3	2.7	1.8
Switzerland	0.1	0.9	0.4	-0.8	0.5	0.2	0.2
Norway*	2.0	1.5	2.2	3.0	1.5	1.3	1.5
US*	1.7	2.4	1.8	1.2	4.2	2.3	1.9
Japan*	0.3	0.9	0.5	0.0	0.2	0.8	0.2

Source: Refinitiv, Capital Economics. *Domestic measures, CPI-ATE for Norway, CPIF for Sweden.

Detailed Forecasts – Current Account & Unemployment

Table 20: Current Account

% GDP	Average 08-17	2018	2019	2020	2021f	2022f	2023f
Germany	6.9	7.5	7.2	7.0	6.0	6.0	6.0
France	-0.7	-0.6	-0.7	-2.3	-0.5	-0.3	-0.3
Italy	-0.1	2.6	3.3	3.7	3.5	3.3	3.3
Spain	-0.8	1.9	2.1	0.7	-0.3	-0.3	0.3
Netherlands	7.9	10.8	9.9	7.8	8.0	9.0	9.0
Belgium	0.5	-0.8	0.3	-0.2	0.0	0.3	0.3
Austria	2.3	1.3	2.8	2.5	2.5	2.0	2.0
Ireland	-1.4	6.0	-11.4	4.6	11.0	6.5	7.0
Greece	-5.7	-2.9	-1.5	-6.7	-2.0	-4.0	-4.0
Portugal	-3.5	0.6	0.4	-1.2	-0.5	0.3	0.5
Finland	-0.4	-1.8	-0.3	0.3	-1.0	-1.0	-1.0
Slovakia	-2.2	-2.5	-2.9	-0.3	0.5	0.0	0.3
Slovenia	1.6	5.8	5.6	7.1	7.0	6.5	6.0
Luxembourg	5.6	4.8	4.6	4.3	5.0	5.0	4.5
Cyprus	-5.7	-3.9	-6.5	-12.0	-8.5	-6.0	-5.5
Euro-zone	**1.1**	**3.1**	**2.4**	**2.1**	**2.4**	**2.3**	**2.4**
Sweden	4.8	2.6	5.1	5.2	5.0	4.5	4.0
Denmark	6.7	7.0	8.9	7.8	6.0	8.0	7.0
EU 27	**1.4**	**3.1**	**2.7**	**2.4**	**2.6**	**2.5**	**2.5**
UK	-4.0	-3.7	-3.1	-3.5	-3.6	-3.4	-2.6
Switzerland	8.9	6.7	6.7	3.8	6.0	7.5	7.5
Norway	10.0	8.0	2.8	1.9	4.5	5.0	5.5
US	-2.6	-2.2	-2.2	-3.1	-3.2	-2.9	-2.5
Japan	2.5	3.5	3.4	3.2	3.5	3.5	3.6

Sources: Refinitiv, Capital Economics

Table 21: Unemployment Rate

% workforce, year average	Average 08-17	2018	2019	2020	2021f	2022f	2023f
Germany	5.6	3.4	3.0	3.9	3.8	3.5	3.5
France	9.5	9.0	8.4	8.0	8.0	7.5	7.5
Italy	10.3	10.7	10.0	9.3	10.3	9.8	9.5
Spain	20.5	15.2	14.1	15.5	15.3	14.5	13.8
Netherlands	5.6	3.8	3.4	3.8	3.3	3.0	3.0
Belgium	7.8	6.0	5.4	5.6	6.5	6.0	5.5
Austria	5.6	5.2	4.8	6.1	6.0	5.0	4.8
Ireland	11.6	5.8	5.0	5.8	8.5	8.3	6.4
Greece	19.7	19.3	17.3	16.4	16.3	15.8	14.8
Portugal	12.7	7.2	6.7	7.1	7.0	6.8	6.5
Finland	8.3	7.4	6.7	7.8	7.5	6.5	5.5
Slovakia	12.1	6.6	5.8	6.7	7.3	6.7	5.7
Slovenia	7.8	5.1	4.4	5.0	5.0	4.5	4.5
Luxembourg	5.4	5.5	5.6	6.7	6.8	6.3	6.0
Cyprus	10.6	8.4	7.0	7.7	8.8	7.5	6.5
Euro-zone	**10.3**	**8.2**	**7.6**	**7.9**	**8.0**	**7.3**	**7.0**
Sweden	7.6	6.3	6.8	8.3	7.2	6.2	5.8
Denmark	6.6	5.1	5.0	5.6	5.8	5.0	4.5
EU 27	**9.7**	**7.2**	**6.7**	**7.1**	**7.9**	**7.2**	**6.9**
UK	6.6	4.1	3.8	4.5	4.7	5.0	4.0
Switzerland	3.1	2.6	2.3	3.1	3.8	3.0	2.5
Norway	3.7	3.9	3.7	4.6	4.5	3.0	2.8
US	7.0	3.9	3.7	8.1	5.6	4.4	3.8
Japan	4.0	2.4	2.4	2.8	2.8	2.5	2.4

Sources: Refinitiv, Capital Economics

Detailed Forecasts – Budget Deficit & Government Debt

Table 22: Government Budget Balance

% GDP	Average 08-17	2018	2019	2020	2021f	2022f	2023f
Germany	-0.4	1.8	1.5	-4.2	-4.0	-1.0	0.0
France	-4.6	-2.3	-3.1	-9.2	-9.0	-6.0	-4.5
Italy	-3.2	-2.2	-1.6	-9.5	-11.0	-5.5	-3.5
Spain	-7.1	-2.5	-2.9	-11.0	-9.0	-7.0	-5.0
Netherlands	-2.4	1.4	1.8	-4.3	-4.0	-2.5	-2.0
Belgium	-3.1	-0.8	-1.9	-9.4	-8.0	-5.0	-4.0
Austria	-2.4	0.2	0.6	-8.9	-7.5	-3.0	-2.5
Ireland	-8.7	0.1	0.5	-5.0	-4.0	-2.0	-1.5
Greece	-7.7	0.9	1.1	-9.7	-8.0	-3.5	-2.5
Portugal	-6.1	-0.3	0.1	-5.7	-5.0	-2.0	-1.5
Finland	-1.4	-0.9	-0.9	-5.4	-4.5	-3.0	-2.0
Slovakia	-3.9	-1.0	-1.3	-6.2	-5.5	-4.0	-3.3
Slovenia	-4.8	0.7	0.4	-8.4	-7.0	-5.5	-4.5
Luxembourg	1.1	3.0	2.4	-4.1	-1.5	-0.5	-0.5
Cyprus	-3.4	-3.5	1.5	-5.7	-3.0	-1.0	-0.5
Euro-zone	**-3.2**	**-0.5**	**-0.6**	**-7.2**	**-7.0**	**-3.8**	**-2.5**
Sweden	-0.1	0.8	0.6	-3.1	-2.0	-1.0	0.0
Denmark	-0.7	0.7	3.8	-1.1	-2.0	-2.0	-1.0
EU 27	**-3.1**	**-0.4**	**-0.5**	**0.0**	**-6.7**	**-3.6**	**-2.4**
UK[1]	-5.9	-1.8	-2.6	-16.9	-14.3	-9.5	-3.5
Switzerland	0.5	1.3	1.4	-2.6	-2.0	-1.0	0.0
Norway	10.1	6.9	5.6	-7.0	0.0	2.0	3.0
US[2]	-5.3	-3.8	-4.6	-3.6	-13.4	-4.7	-3.1
Japan	-6.8	-2.7	-3.1	-10.1	-8.0	-6.0	-5.0

Sources: Refinitiv, Capital Economics. 1) Fiscal year. 2) Federal.

Table 23: Gross Government Debt

% of GDP	Average 08-17	2018	2019	2020	2021f	2022f	2023f
Germany	74	62	60	70	69	66	64
France	90	98	98	116	116	116	116
Italy	126	134	135	156	157	155	155
Spain	80	97	96	120	120	119	117
Netherlands	62	52	49	55	55	55	52
Belgium	103	100	98	114	114	113	111
Austria	81	74	71	84	87	83	82
Ireland	86	64	61	60	59	58	57
Greece	162	186	181	206	198	196	195
Portugal	116	122	117	134	135	129	126
Finland	53	60	60	69	71	71	71
Slovakia	47	49	48	61	62	62	62
Slovenia	58	70	66	81	82	85	82
Luxembourg	20	21	22	25	25	24	24
Cyprus	82	99	94	118	114	111	105
Euro-zone	**87**	**86**	**84**	**98**	**98**	**97**	**95**
Sweden	40	39	35	40	44	43	42
Denmark	41	34	33	42	39	40	40
EU (27)	**81**	**80**	**78**	**0**	**95**	**93**	**92**
UK	63	80	85	100	107	106	103
Switzerland	42	39	40	43	43	43	42
Norway	37	40	41	41	40	40	40
US	66	77	79	98	104	103	101.5
Japan	221	233	235	255	256	255	255

Sources: Refinitiv, Capital Economics. 1) Fiscal year. 2) Federal debt.

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