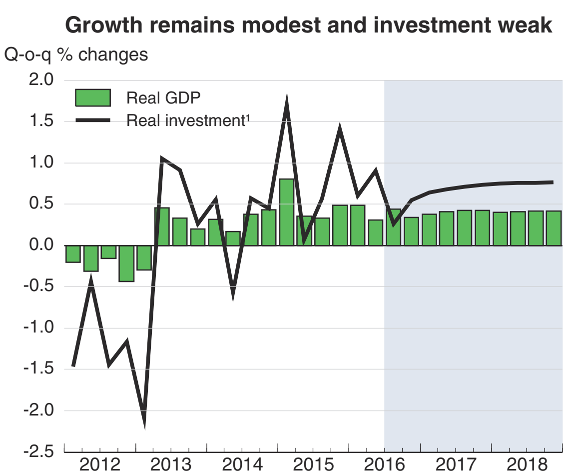
EURO AREA

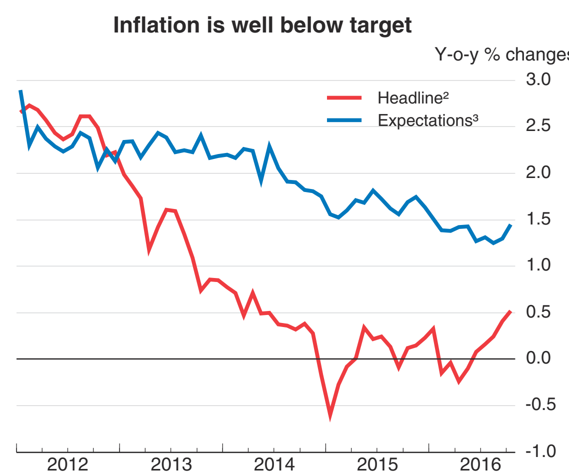
Economic growth is projected to remain subdued. Despite supportive monetary conditions, investment weakness will persist, reflecting low demand, banking sector fragilities and uncertainties about European integration. High unemployment and modest wage growth will hold back private consumption, while exports will be hampered by soft global trade and by weaker growth in the United Kingdom following the Brexit referendum. Inflation is set to rise very gradually. Across euro area countries, major differences in growth and unemployment prospects will persist.

The monetary policy stance should remain accommodative until inflation is clearly rising to the target of near 2%. However, monetary policy has become overburdened and should get more support from fiscal and structural policies. The projected fiscal stance is only slightly expansionary: a stronger fiscal stimulus with accompanying growth-friendly changes in the spending and taxation structure would rebalance the policy mix and support long-term growth. Completing the Single Market in services and network sectors would boost investment and productivity. Faster resolution of non-performing loans is also essential for stronger investment and may require establishing asset management companies and waiving existing bail-in procedures. Completion of the banking union would strengthen confidence and resilience to future crises.

Very low interest rates have created additional fiscal space by reducing interest payments and allowing temporarily higher debt in several countries without triggering negative market reactions. This space should be used to support growth. High-quality infrastructure projects, like those reinforcing Trans-European networks, would support demand and raise output capacity. For this purpose, the conditions of the Stability and Growth Pact investment clause should be eased. To promote job creation and social mobility, countries should also shift taxes away from labour and prioritise spending on education and childcare.

Euro area





1. Total gross fixed capital formation.
2. Harmonised index of consumer prices.
3. Expected average annual inflation based on the difference between 5-year and 10-year inflation swaps.

Source: OECD Economic Outlook 100 database; Eurostat; and Thomson Reuters.

StatLink http://dx.doi.org/10.1787/888933437589

Euro area: **Employment, income and inflation**

Percentage changes

	2014	2015	2016	2017	2018
Employment	0.6	1.0	1.8	1.2	1.0
Unemployment rate[1]	11.6	10.9	10.0	9.5	9.1
Compensation per employee[2]	1.4	1.4	1.3	1.8	2.0
Labour productivity	0.6	0.8	0.2	0.4	0.7
Unit labour cost	0.7	0.8	1.1	1.2	1.2
Household disposable income	1.2	2.1	2.2	2.5	2.7
GDP deflator	0.9	1.1	1.0	1.1	1.3
Harmonised index of consumer prices	0.4	0.0	0.2	1.2	1.4
Core harmonised index of consumer prices[3]	0.8	0.8	0.9	1.1	1.4
Private consumption deflator	0.5	0.2	0.3	1.0	1.2

Note: Covers the euro area countries that are members of the OECD.
1. As a percentage of labour force.
2. In the total economy.
3. Harmonised index of consumer prices excluding energy, food, drink and tobacco.

Source: OECD Economic Outlook 100 database.

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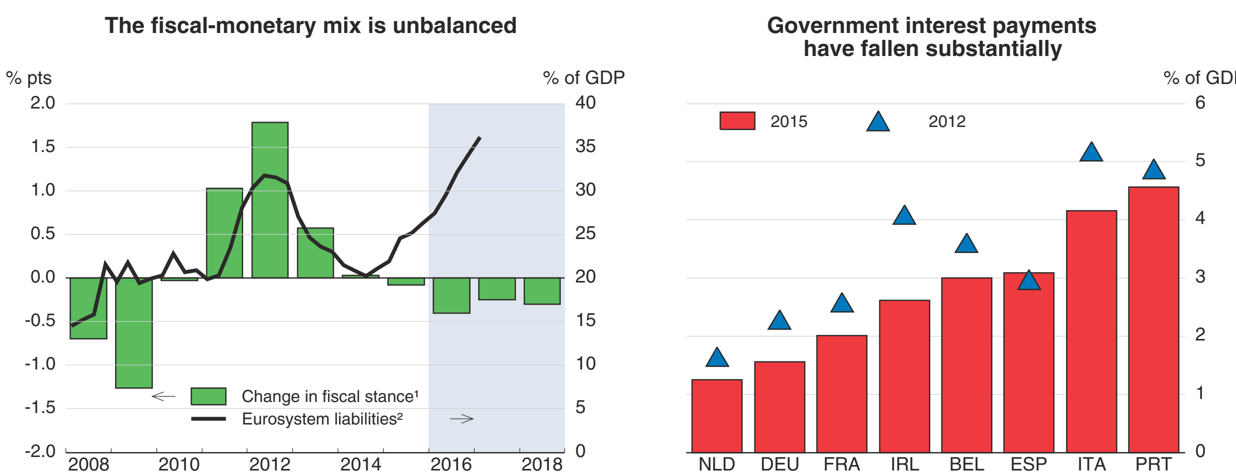
Growth and investment have continued to disappoint

Growth slowed somewhat in the course of 2016, reflecting weakness in both exports and domestic demand. In particular, business investment has once more failed to display a sustained recovery. Weaker imports have helped to keep the area-wide current account surplus very large. Unemployment has continued to decline only gradually. The dissipation of effects from past falls in energy prices has increased consumer price inflation modestly, but core inflation (which excludes energy) has remained weak, reflecting a weak economy. Market-based inflation expectations have been trending downwards for some time until very recently.

Euro area



1. Change in the underlying primary balance as a percentage of potential GDP.
2. Estimates from fourth quarter of 2016 based on monthly increases of EUR 80 billion until March 2017.

Source: OECD Economic Outlook 100 database; and Thomson Reuters.

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Euro area: **Financial indicators**

	2014	2015	2016	2017	2018
Household saving ratio, net[1]	6.0	6.0	6.2	6.2	6.1
General government financial balance[2]	-2.6	-2.1	-1.8	-1.5	-1.3
General government gross debt[2]	111.9	109.5	108.9	108.1	106.9
General government debt, Maastricht definition[2]	94.5	92.8	92.2	91.4	90.2
Current account balance[2]	3.0	3.9	4.1	4.0	4.0
Short-term interest rate[3]	0.2	0.0	-0.3	-0.3	-0.3
Long-term interest rate[4]	2.0	1.1	0.8	0.6	0.6

Note: Covers the euro area countries that are members of the OECD.
1. As a percentage of disposable income.
2. As a percentage of GDP.
3. 3-month interbank rate.
4. 10-year government bonds.

Source: OECD Economic Outlook 100 database.

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Economic performance has remained divergent across countries, in line with the patterns observed in recent years. Activity in Germany has generally continued to outpace that in France and Italy, in tandem with a much lower unemployment rate. Among the countries hit hardest by the sovereign debt crisis, Ireland and Spain have maintained much stronger growth than their peers, with the recovery in Spain being boosted by a significant easing of fiscal policy.

Fiscal and structural policies need to do more for growth and equity

Modest growth prospects, high levels of private debt and uncertainty about the future of European integration continue to hamper private domestic demand, and especially investment. Furthermore, bank lending remains too weak, especially in countries with high levels of non-performing loans. Subdued global trade and slower growth in the United

Euro area: **Demand and output**

	2015	2016	2017	2018	Fourth quarter 2016	Fourth quarter 2017	Fourth quarter 2018
	Current prices EUR billion	Percentage changes from previous year, volume (2014 prices)					
GDP at market prices	10 387.8	1.7	1.6	1.7	1.6	1.6	1.7
Private consumption	5 705.2	1.6	1.4	1.5	1.4	1.5	1.5
Government consumption	2 153.0	1.8	1.3	1.2	1.4	1.4	1.1
Gross fixed investment	2 049.6	3.0	2.5	3.0	2.3	2.8	3.1
Final domestic demand	9 907.8	1.9	1.6	1.7	1.6	1.7	1.7
Stockbuilding[1]	7.9	-0.1	0.0	0.0			
Total domestic demand	9 915.7	1.8	1.6	1.7	1.4	1.7	1.7
Net exports[1]	472.1	-0.1	0.0	0.0			

Note: Detailed quarterly projections are reported for the major seven countries, the euro area and the total OECD in the Statistical Annex. Covers the euro area countries that are members of the OECD.
1. Contributions to changes in real GDP, actual amount in the first column.

Source: OECD Economic Outlook 100 database.

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Euro area: **External indicators**

	2014	2015	2016	2017	2018
	USD billion				
Foreign balance	473.0	523.7	564.2	568	586
Invisibles, net	- 73.8	- 78.1	- 79.0	- 94	- 99
Current account balance	399.2	445.6	485.2	474	487

Note: Covers the euro area countries that are members of the OECD.
Source: OECD Economic Outlook 100 database.

StatLink http://dx.doi.org/10.1787/888933438965

Kingdom, a major export partner, following the Brexit decision will weigh on euro-area export growth.

Monetary conditions are projected to remain very accommodative over the projection horizon, with an unchanged policy rate for main refinancing operations and substantial asset purchases, mainly of sovereign bonds, beyond March 2017. This is appropriate given the weak recovery and below-target inflation. But monetary policy alone will not suffice to revive growth. It is increasingly clear that fiscal policy will have to play a larger role if Europe is to escape its low-growth trap.

The projected area-wide fiscal stance is only slightly expansionary in 2017-18. Furthermore, the countries where fiscal expansion is projected to be strongest are not always the ones where fiscal space is the largest, and some expansionary measures already planned will not make the composition of public finances more growth and equity-friendly. Fiscal stimulus should be increased, especially in countries with the most room for manoeuvre. Fiscal policy can also be made more supportive of growth and inclusiveness by reprioritising spending and taxation. Examples include giving higher priority to spending on education and childcare, with accompanying institutional and efficiency improvements, and decreasing labour taxation, especially for low earners. Another example is to focus spending on well-chosen and executed soft and hard infrastructure investments, such as Trans-European railways and energy network projects, which raise aggregate demand and, once in place, aggregate supply. Beyond fiscal policy, product market structural reforms to complete the Single Market in services and network sectors should also receive high priority.

To enable fiscal expansion and make it support growth sustainably, the investment clause of the Stability and Growth Pact (SGP) should be broadened, and the ECOFIN Council should develop a more coherent approach to the use of discretion when applying the SGP, with enhanced consideration of the quality of public finances. Incentives for growth and equity-friendly fiscal expansion could also be strengthened by introducing some conditionality in future sovereign bond purchases by the European Central Bank, linked for example to increases in public investment.

The financial sector also needs to be strengthened. Deepening the banking union through a common backstop to the Single Resolution Fund and deposit insurance at the European level would reinforce confidence in the monetary union and ease the management of future crises. Strengthening the financial sector also requires faster resolution of non-performing loans, which in some cases may require setting up asset management companies and waiving bail-in procedures.

Growth is projected to remain subdued

GDP growth is projected to stabilise at above 1½ per cent in the next two years. Domestic demand will be subdued, reflecting overburdened monetary policy, insufficient fiscal support and several structural bottlenecks. Despite modest export growth, the large current account surplus will persist. The projected decline in unemployment will still leave substantial labour market slack in many countries, and inflation, though gradually increasing, will consequently remain well below 2%.

Rising uncertainty about the modalities of the United Kingdom's exit from the European Union and the subsequent trade arrangements could hamper investment and exports. Financial turbulence abroad would decrease demand for euro area exports and investment. Confidence in the euro area could weaken due to idiosyncratic political or banking sector risks in vulnerable countries. A possible decision by the European Central Bank to taper unconventional policies would reduce risks of financial distortions but could rekindle tensions in sovereign debt markets, with knock-on effects in other asset markets. On the other hand, stronger fiscal and structural policy action than is now envisaged by policymakers would deliver higher growth than projected.