

Euro Area Macro Monitor

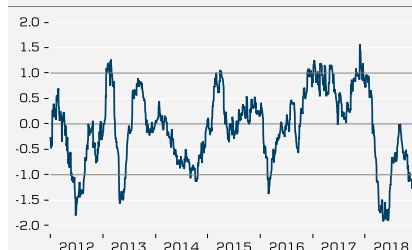
Disappointing data dominate in the euro area

- Activity data have been weak across the board and December PMIs still painted a lacklustre picture of the euro area economy. Particularly service sector activity took a marked hit from the Yellow Vest protests in France, while the manufacturing weakness in Germany continues to persist as car sector bottlenecks abate only slowly. Hence we also expect the growth momentum in Q4 to have remained unchanged at 0.2% q/q from Q3, as many external headwinds (i.e. Brexit, China slowdown etc.) remain in place and idiosyncratic factors (i.e. Yellow Vest protests) have been added to the list of downside risks. Despite lingering growth headwinds near term, we still expect growth in 2019 to remain robust at 1.5%, as continued employment gains and strong real wage growth should support private consumption.
- At the December meeting, the ECB announced a formal end to its asset purchase programme as widely expected, thereby concluding its balance sheet expansion. At the same time, the ECB adjusted its guidance in the reinvestment strategy. The ECB will now reinvest in full at least past the first rate hike, thereby still having an accommodative monetary policy stance well into 2019. On the back of the softer activity data the discussion on the growth risk assessment was particularly interesting. As expected, the ECB kept the overall assessment of the growth outlook as broadly balanced, while also pointing to risks moving to the downside. The meeting also brought new economic forecasts, which - as we expected - saw downward revisions both in near-term growth and inflation outlook but unchanged confidence in the long-term build-up of underlying inflation pressures, see *ECB Review*, 13 December 2018.
- **December HICP inflation** fell back to 1.6% from 1.9% in December and the drop was driven by the lower energy contribution. Core inflation was unchanged at 1.0%. The numbers were lower than we expected, but it does not change our expectation of (core) inflation picking up towards summer on the back of strong euro area wage growth. History indicates that underlying (core) inflation picks up with a three-quarter lag from wage growth. Euro area Q3 wage growth was at a 10-year high of 2.5%. We examined the so-called *Phillips curve*, 18 December 2018, where we argue that the underlying inflation pressures continued their gradual upward trend in 2018, but the impact of higher wages on core inflation has yet to materialise. We expect the pickup from Q2 19 onwards.
- **The Italian budget** fight with the EU is over for now as the *Italian government reached an agreement with the European Commission*, 19 December 2018, on its 2019 budget of 2.04% from originally 2.40%, meaning the risk of an excessive deficit procedure is off the table for now. The quick resort to a solution can be attributed to the Yellow Vest protests in France, weakening the bargaining position of Brussels (France is projected to show a deficit of around 3.3-3.4% of GDP). The Italian budget truce was reached after lengthy negotiations, which importantly will bring the structural deviation down to zero (from a deterioration of 0.8pp previously). However, the structural problems with the Italian economy of e.g. having low growth remain unresolved. The Italian bond market has reacted in general positively to the budget truce, but yields spreads at pre-election levels should not be expected.

Key points

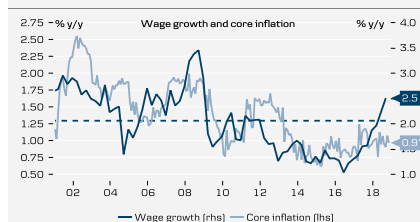
- Activity remained lacklustre in Q4.
- ECB officially ended new QE purchases, but reinvestments to continue.
- Italy-EU budget truce leaving excessive deficit procedure off the table for now.

Euro area surprise indicator points to continued disappointing data



Source: Bloomberg, Macrobond Financial, Danske Bank

No core inflation lift off in sight yet



Source: ECB, Macrobond Financial, Danske Bank

Analyst

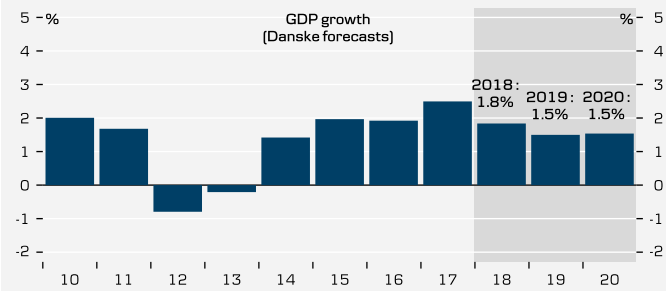
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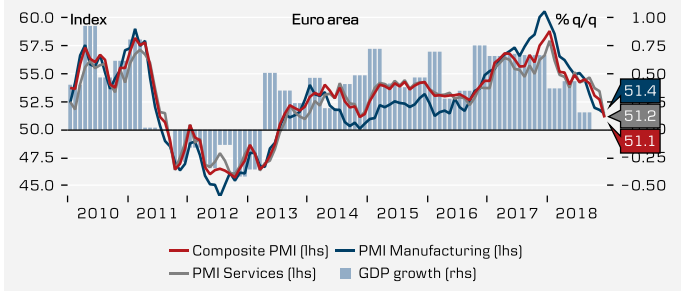
Euro area

GDP growth forecasts



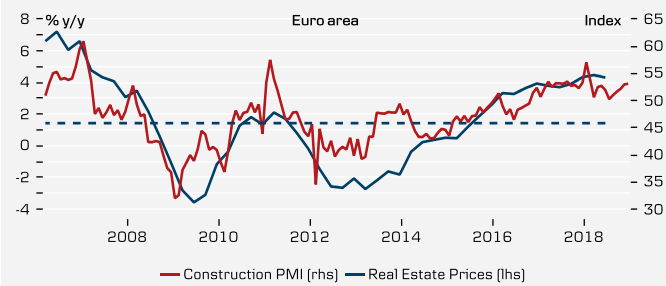
Source: Macrobond Financial, Danske Bank

PMI and GDP growth



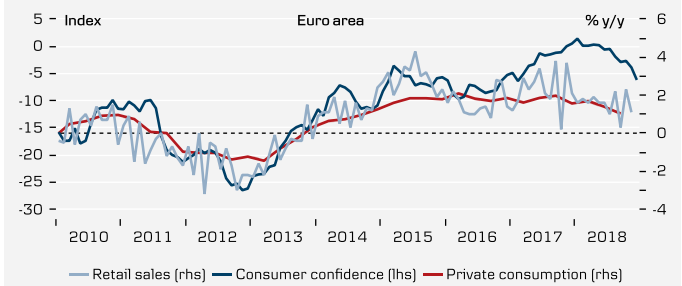
Source: Macrobond Financial, Danske Bank

Housing prices and construction activity



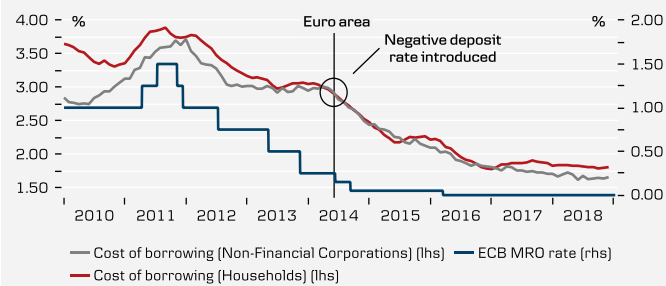
Source: Macrobond Financial, Danske Bank

Consumer confidence and private consumption



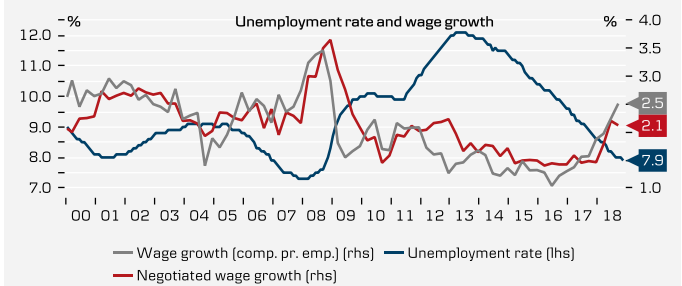
Source: Macrobond Financial, Danske Bank

Borrowing costs



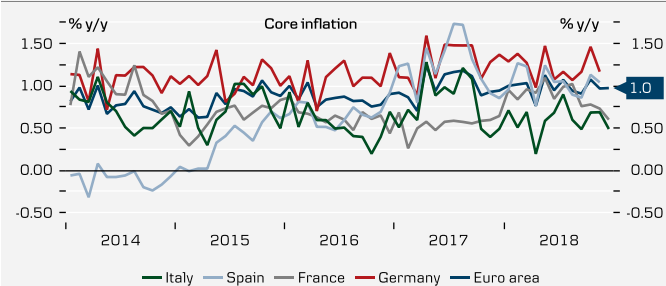
Source: Macrobond Financial, Danske Bank

Unemployment and wage growth



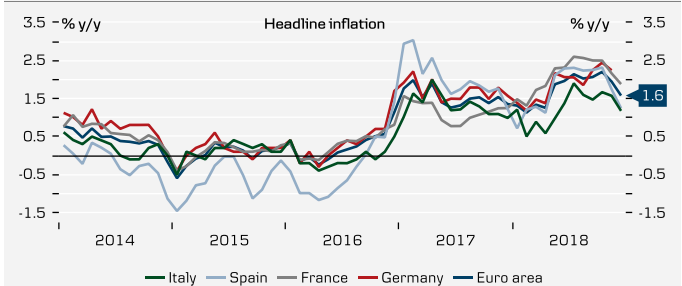
Source: Macrobond Financial, Danske Bank

Core inflation



Source: Macrobond Financial, Danske Bank

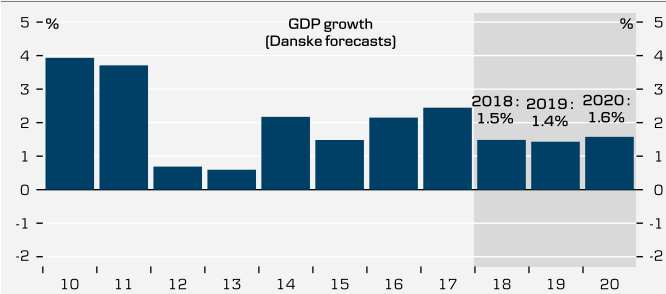
Headline inflation



Source: Macrobond Financial, Danske Bank

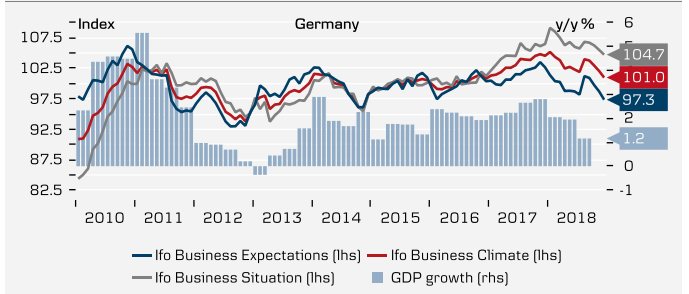
Germany

GDP growth forecasts



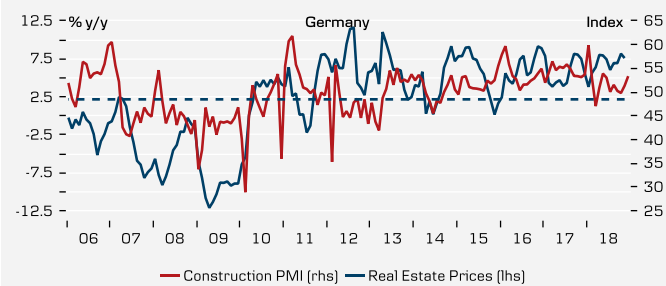
Source: Macrobond Financial, Danske Bank

Ifo and GDP growth



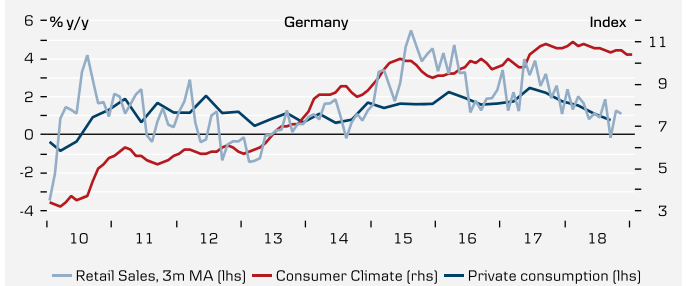
Source: Macrobond Financial, Danske Bank

Housing prices and construction activity



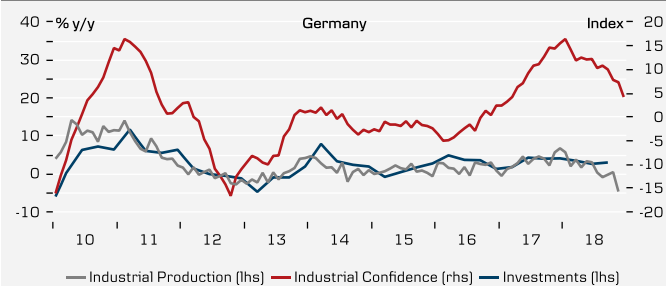
Source: Macrobond Financial, Danske Bank

Consumer confidence and private consumption



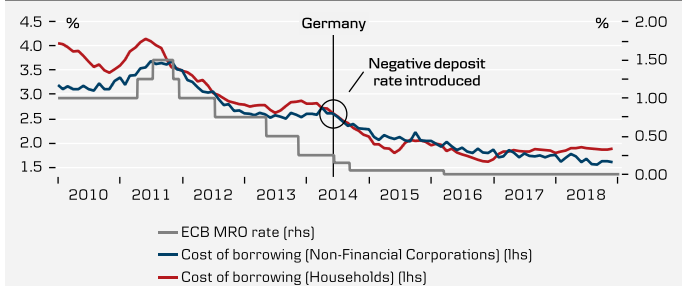
Source: Macrobond Financial, Danske Bank

Industrial production and investments



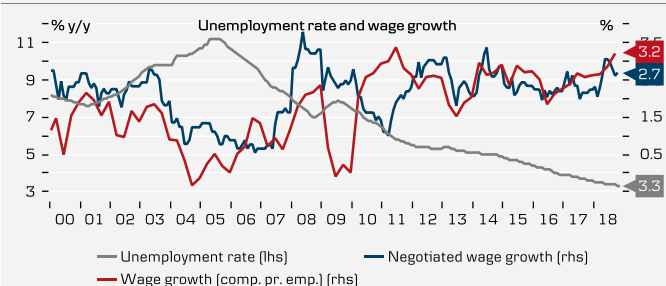
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Borrowing costs



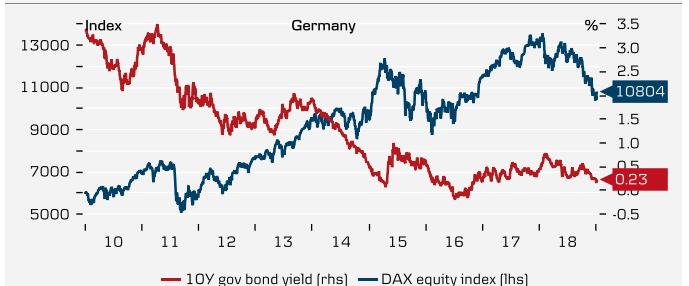
Source: Macrobond Financial, Danske Bank

Unemployment and wage growth



Source: Macrobond Financial, Danske Bank

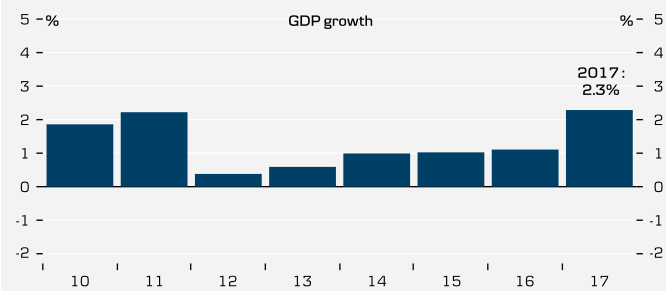
Financial markets



Source: Macrobond Financial, Danske Bank

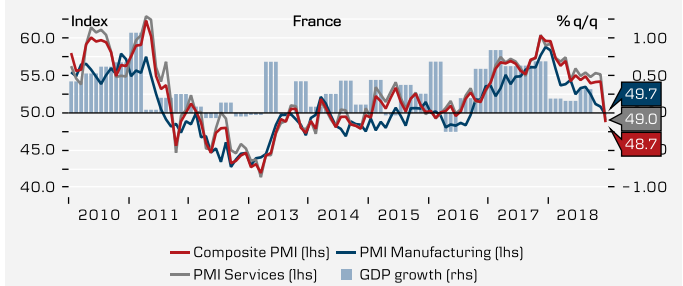
France

GDP growth forecasts



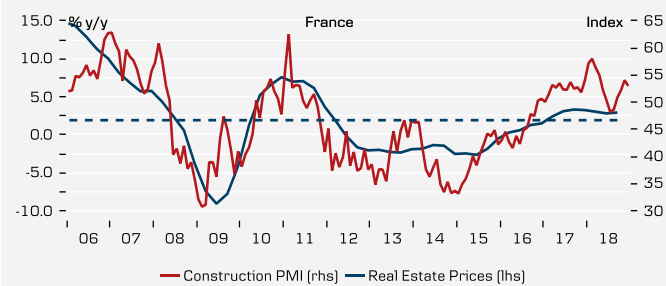
Source: Macrobond Financial, Danske Bank

PMI and GDP growth



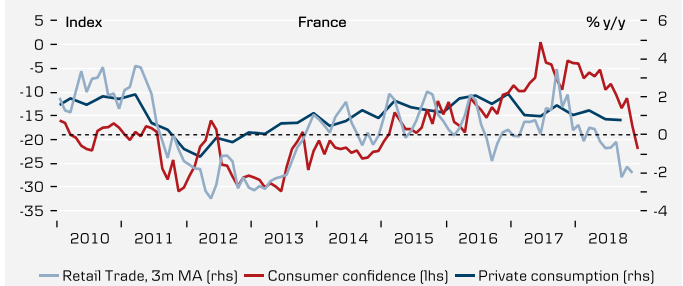
Source: Macrobond Financial, Danske Bank

Housing prices and construction activity



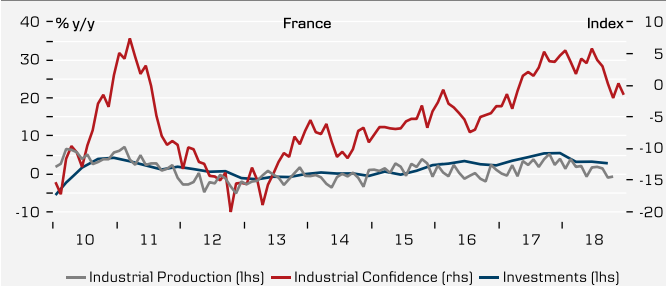
Source: Macrobond Financial, Danske Bank

Consumer confidence and private consumption



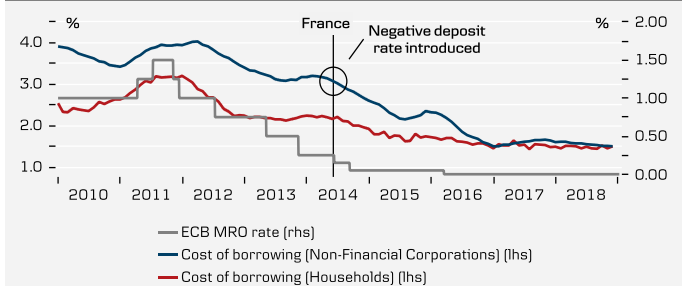
Source: Macrobond Financial, Danske Bank

Industrial production and investments



Source: Macrobond Financial, Danske Bank

Borrowing costs



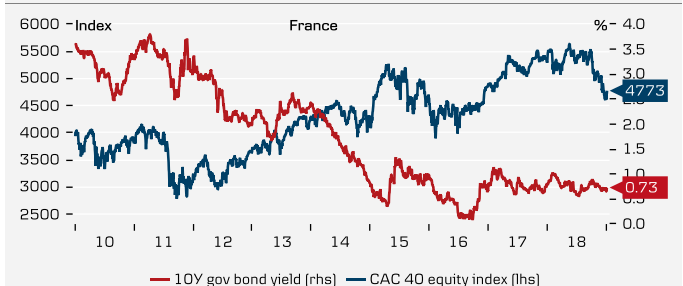
Source: Macrobond Financial, Danske Bank

Unemployment and wage growth



Source: Macrobond Financial, Danske Bank

Financial markets



Source: Macrobond Financial, Danske Bank

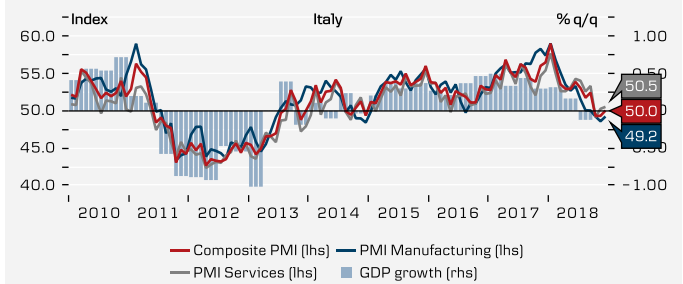
Italy

GDP growth forecasts



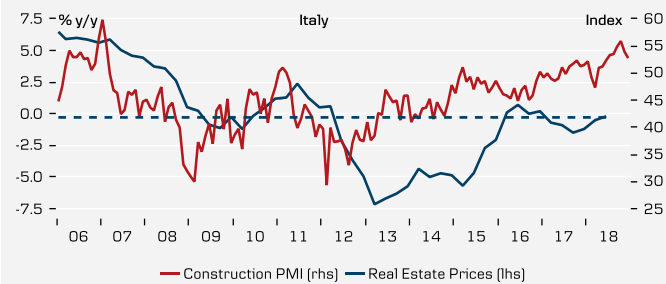
Source: Macrobond Financial, Danske Bank

PMI and GDP growth



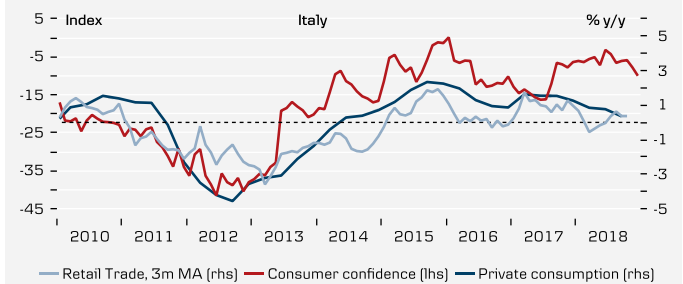
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Housing prices and construction activity



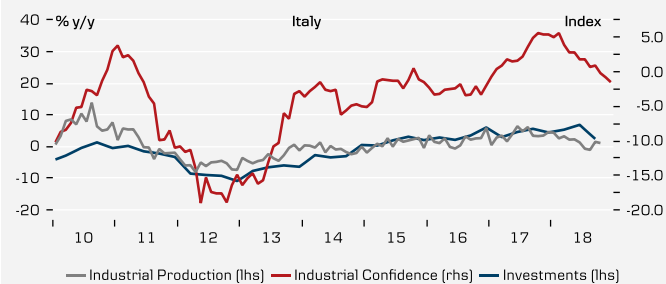
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Consumer confidence and private consumption



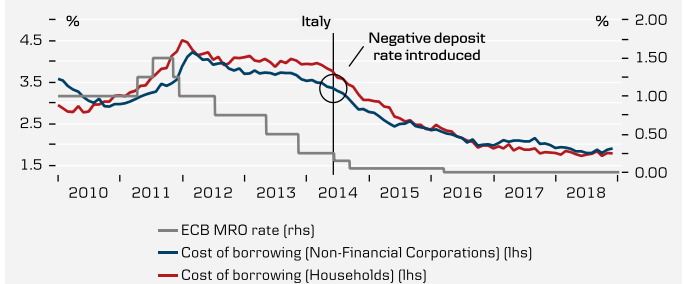
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Industrial production and investments



Source: Macrobond Financial, Danske Bank

Borrowing costs



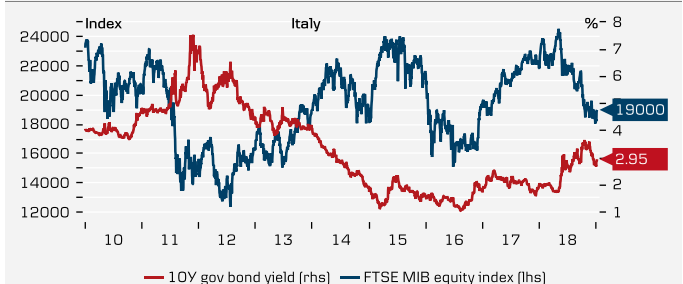
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Unemployment and wage growth



Source: Macrobond Financial, Danske Bank

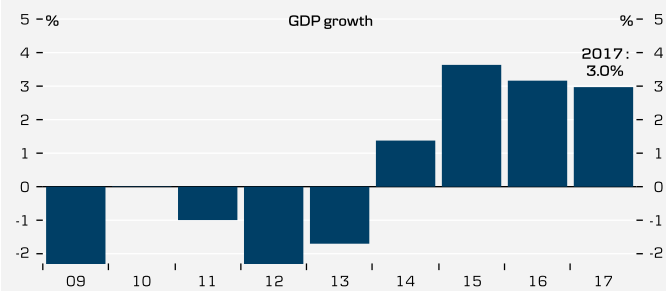
Financial markets



Source: Macrobond Financial, Danske Bank

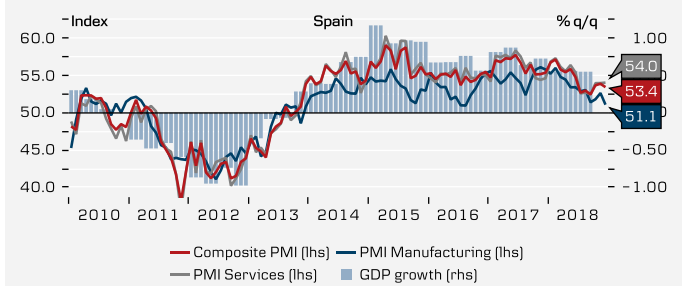
Spain

GDP growth forecasts



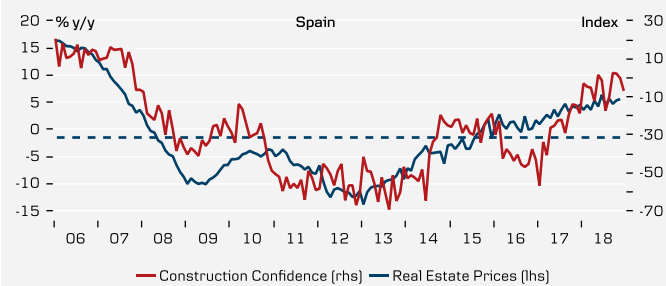
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PMI and GDP growth



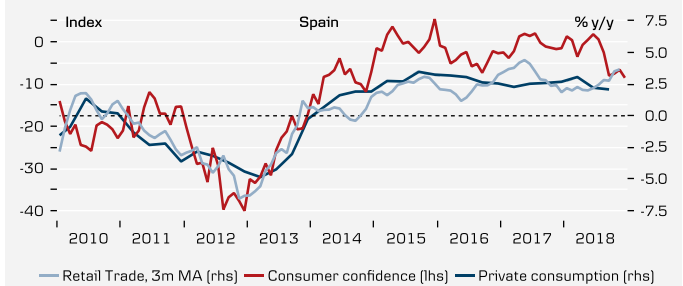
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Housing prices and construction activity



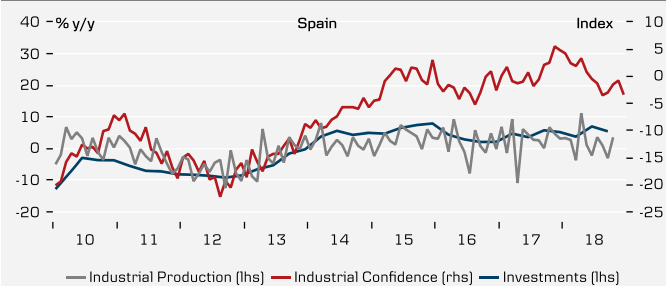
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Consumer confidence and private consumption



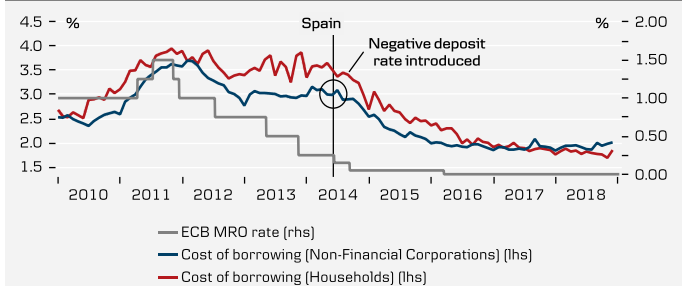
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Industrial production and investments



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Borrowing costs



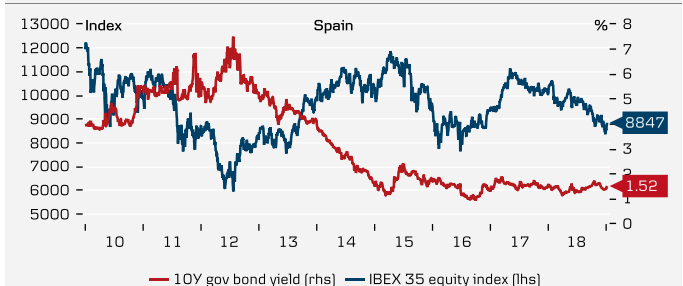
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Unemployment and wage growth



Source: Macrobond Financial, Danske Bank

Financial markets



Source: Macrobond Financial, Danske Bank

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This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Aila Mihr, Analyst, and Piet P. H. Christiansen, Senior Analyst.

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Ad hoc.

Date of first publication

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