

Euro Area Macro Monitor

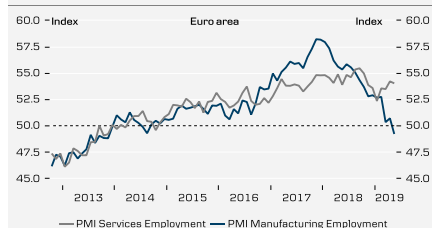
Increasing risks – but baseline persists

- Just as **European sentiment indicators** were showing signs of improvement, confidence took a hit from the renewed escalation of the US-China trade war and potential US-Mexico tariffs. With external demand remaining a headwind, the longevity of the expansion will increasingly depend on developments in domestic demand. In that light it is reassuring that private consumption in Germany jumped by the most in eight years in Q1 and that May's service PMI remained in expansionary territory at 52.9. However, although activity in the services sector continues to hold up well overall, new incoming business and expectations eased, raising the risk that the manufacturing slowdown is spreading to the current engine of growth. Another risk relates to the labour market, where manufacturers have reportedly started to reduce staffing in light of weaker sales prospects and rising geopolitical uncertainty. All that leads us to conclude that the euro area will not be able to maintain its current growth pace of 0.4% q/q in the coming quarters, though we remain some way off recessionary territory (see growth tracker). We also updated our economic outlook, including a 2021 forecast, see *Renewed Trade Dispute Casts Shadow Over Global Economy p12*, 10 June.
- At the policy meeting last week, the **ECB** decided to extend the forward guidance to 'at present levels at least through H1 2020' as well as announce the liquidity operation details (TLTRO3). The updated staff projections were broadly unchanged, leading to an unchanged baseline narrative, although the external environment posed a more prominent risk than previously. In light of the increased risks, the ECB made clear that it is ready to act should it be needed. Therefore, we expect the ECB to step up its policy stimuli only if we see a deterioration beyond the already expected slowdown near term.
- As fears about a cyclical downturn in the economy have intensified, market-based **inflation** expectations have continued to slide. As the Easter boost to travel-related service prices waned, core disappointed and fell back to 0.8% in May. We do not throw in the towel on our relatively upbeat inflation projections for this year, as we still wait for the details of the drivers for May's low print. Looking ahead, we continue to find reasons to expect core inflation to trend gradually upwards towards year-end, albeit we acknowledge downside risks to our inflation forecast as outlined in *Inflation under the microscope: simmering, not boiling*, 10 May.
- Although the **EU elections** saw shrinking support for established parties in many countries, the influence of eurosceptic groups in terms of policy-making will remain limited with a vote share of 23%. Losses for the Social Democrats and Conservatives - which lost their absolute majority for the first time since 1979 - were amply offset by gains for the Greens and Liberals, meaning that overall sentiment in parliament will remain pro-EU. The focus in Brussels now reverts to choosing a successor for Jean-Claude Juncker as Commission president, but a vote is unlikely to take place before July and might well be delayed into the autumn. The nationality of the next EU Commission president is also important when it comes to the ECB presidency succession (see also *Let the EU 'Game of Thrones' begin*, 27 May).

Key points

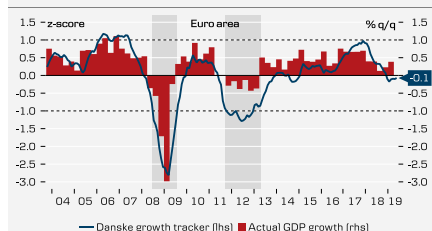
- Increased risks surrounding the euro area.
- ECB will react if needed.
- Influence of eurosceptic parties in EU parliament to remain limited.

Manufacturers have started to reduce staffing



Source: Markit, Eurostat, Macrobond Financial

Danske growth tracker signals recession risk still low



Source: Eurostat, Macrobond Financial

Senior Analyst

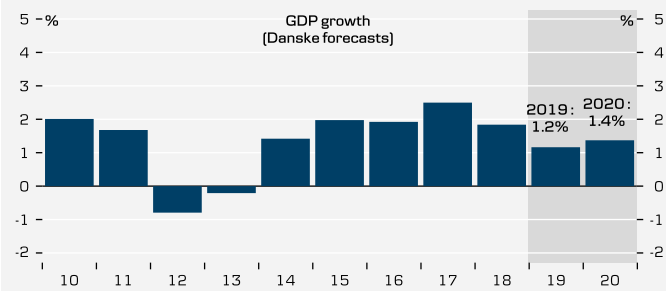
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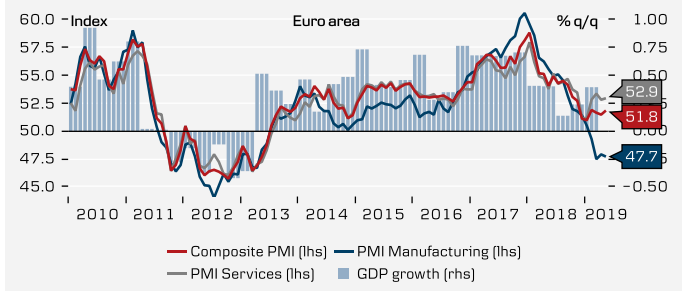
Euro area

GDP growth forecasts



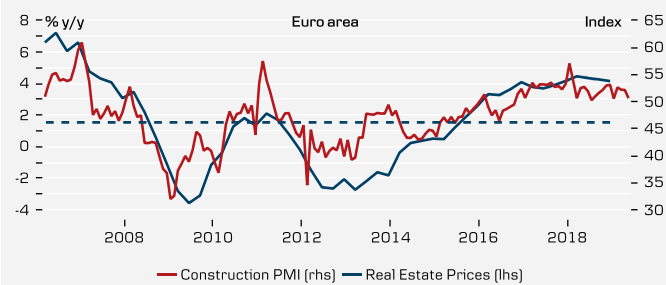
Source: Macrobond Financial, Danske Bank

PMI and GDP growth



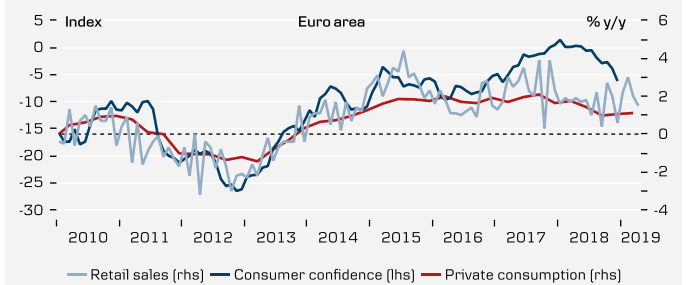
Source: Macrobond Financial, Danske Bank

Housing prices and construction activity



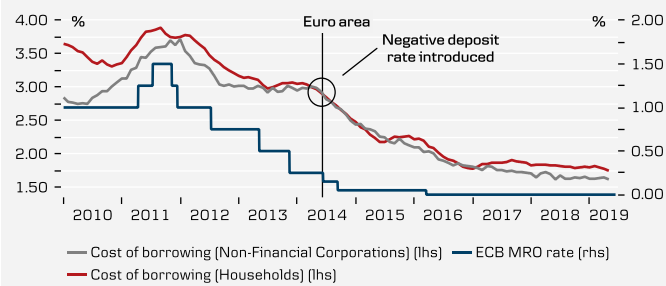
Source: Macrobond Financial, Danske Bank

Consumer confidence and private consumption



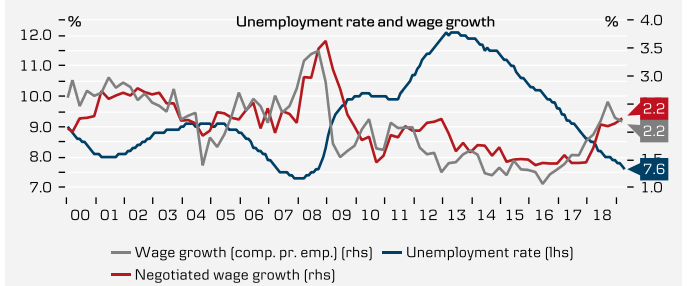
Source: Macrobond Financial, Danske Bank

Borrowing costs



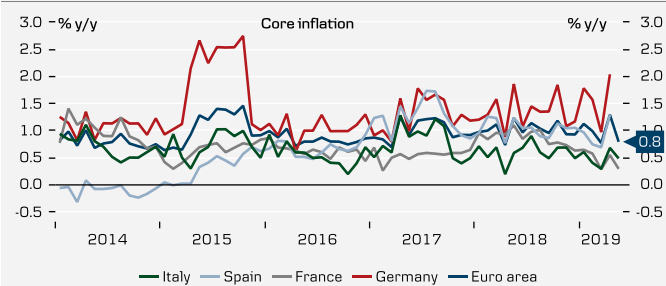
Source: Macrobond Financial, Danske Bank

Unemployment and wage growth



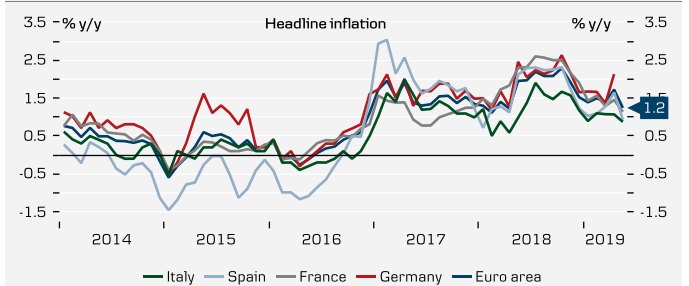
Source: Macrobond Financial, Danske Bank

Core inflation



Source: Macrobond Financial, Danske Bank

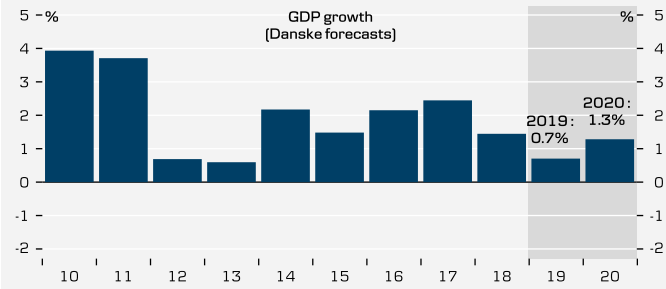
Headline inflation



Source: Macrobond Financial, Danske Bank

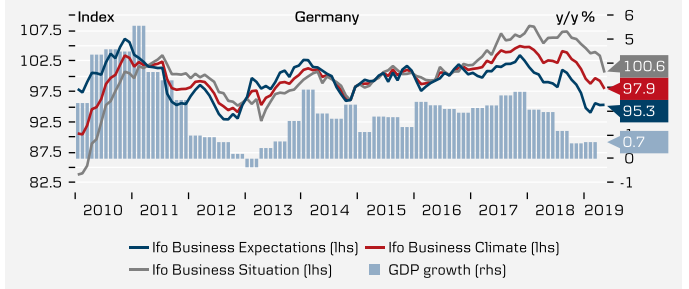
Germany

GDP growth forecasts



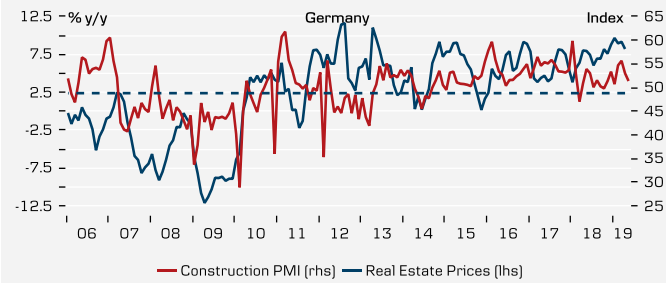
Source: Macrobond Financial, Danske Bank

Ifo and GDP growth



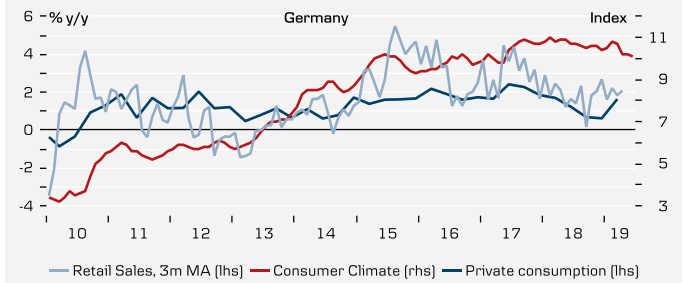
Source: Macrobond Financial, Danske Bank

Housing prices and construction activity



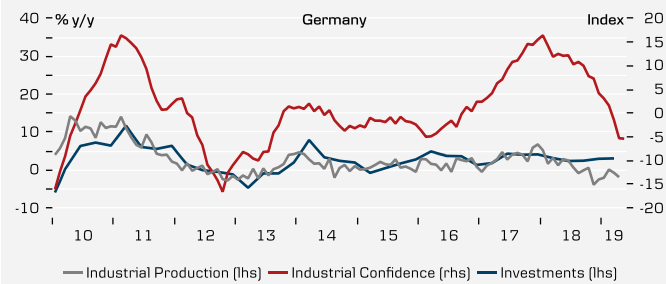
Source: Macrobond Financial, Danske Bank

Consumer confidence and private consumption



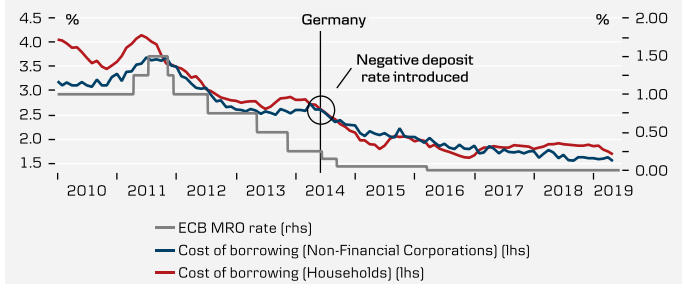
Source: Macrobond Financial, Danske Bank

Industrial production and investments



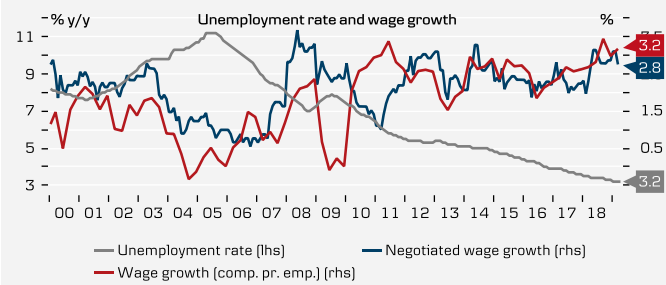
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Borrowing costs



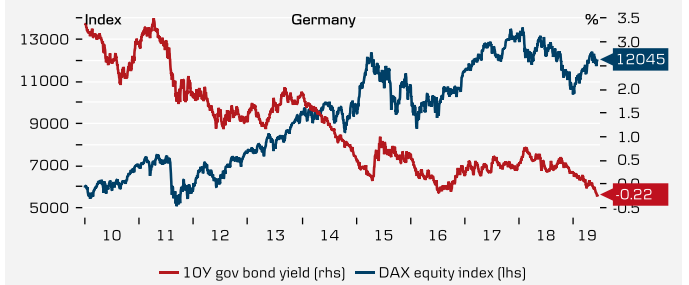
Source: Macrobond Financial, Danske Bank

Unemployment and wage growth



Source: Macrobond Financial, Danske Bank

Financial markets



Source: Macrobond Financial, Danske Bank

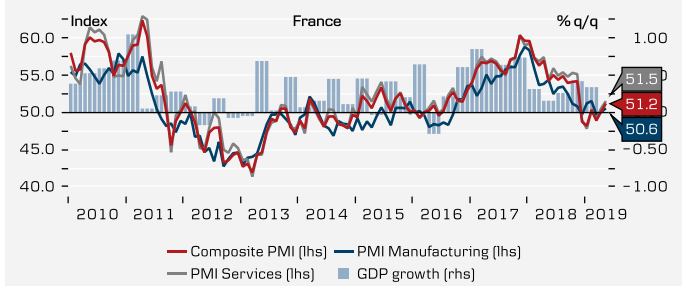
France

GDP growth forecasts



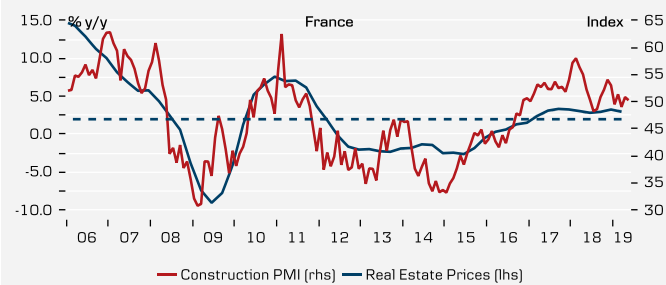
Source: Macrobond Financial, Danske Bank

PMI and GDP growth



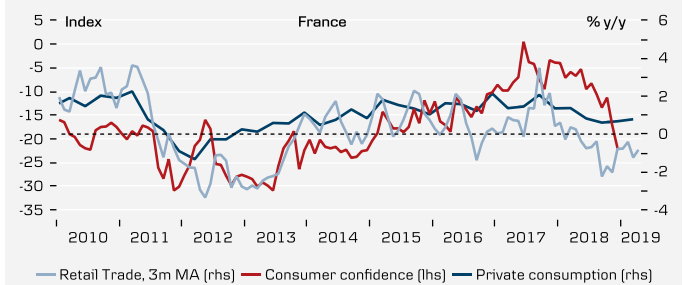
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Housing prices and construction activity



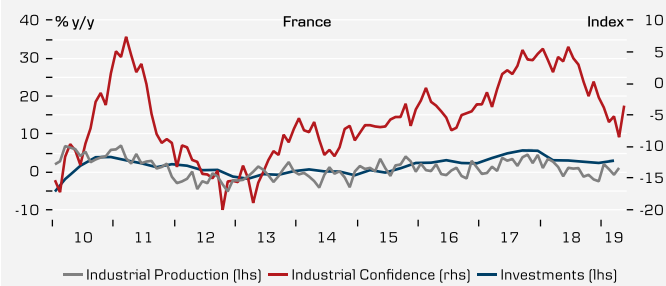
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Consumer confidence and private consumption



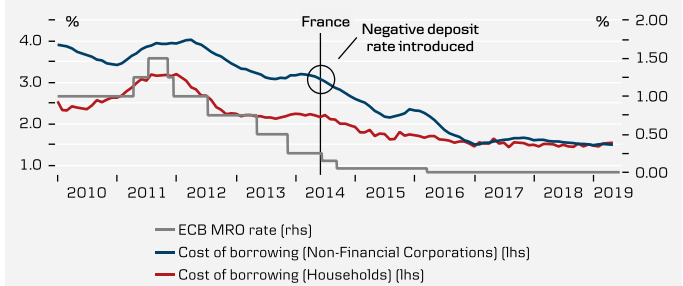
Source: Macrobond Financial, Danske Bank

Industrial production and investments



Source: Macrobond Financial, Danske Bank

Borrowing costs



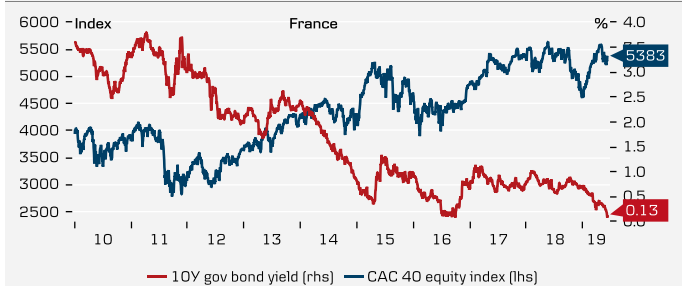
Source: Macrobond Financial, Danske Bank

Unemployment and wage growth



Source: Macrobond Financial, Danske Bank

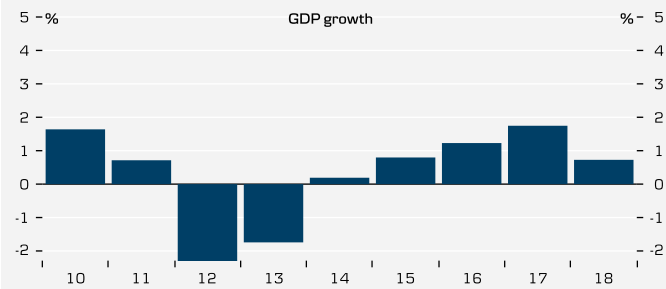
Financial markets



Source: Macrobond Financial, Danske Bank

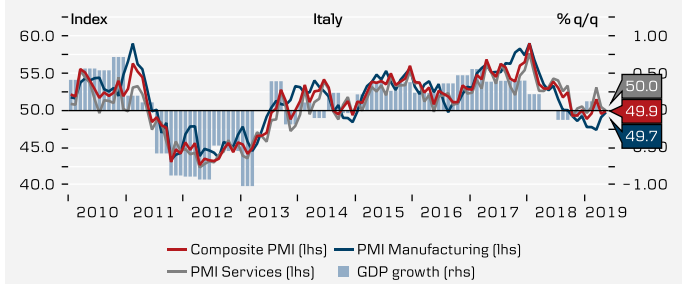
Italy

GDP growth forecasts



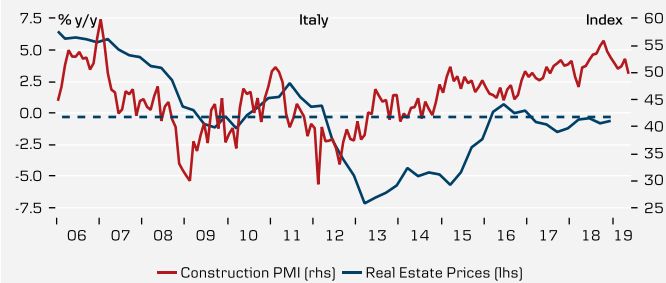
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PMI and GDP growth



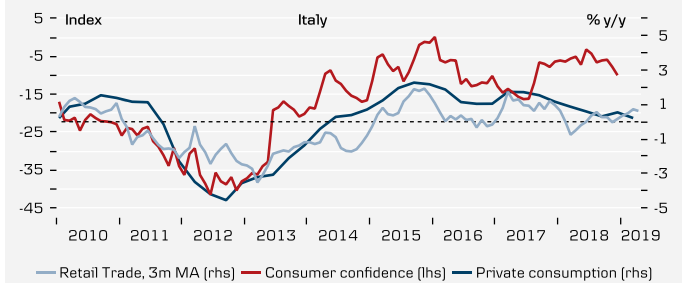
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Housing prices and construction activity



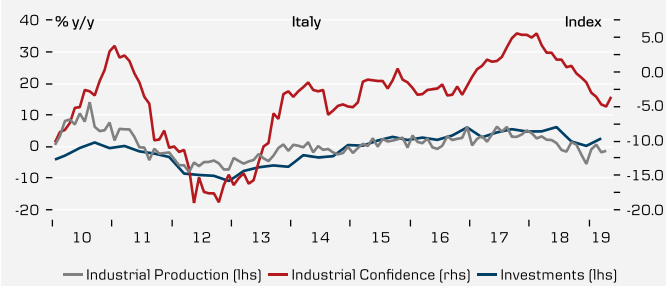
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Consumer confidence and private consumption



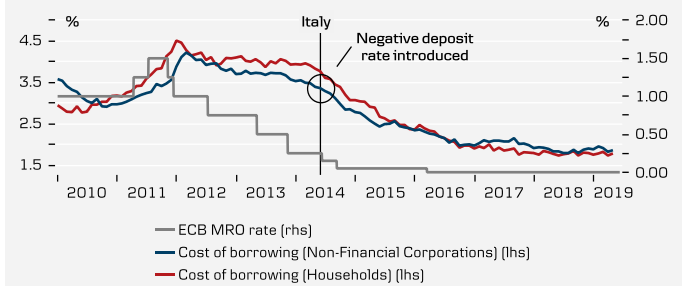
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Industrial production and investments



Source: Macrobond Financial, Danske Bank

Borrowing costs



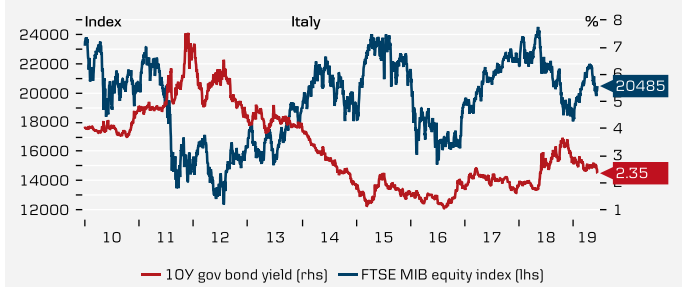
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Unemployment and wage growth



Source: Macrobond Financial, Danske Bank

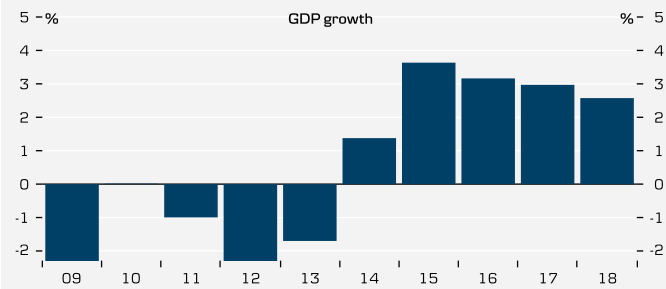
Financial markets



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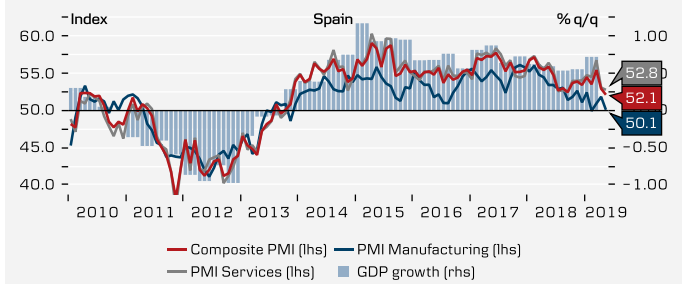
Spain

GDP growth forecasts



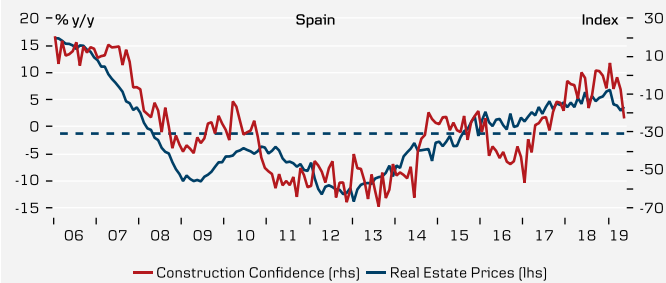
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PMI and GDP growth



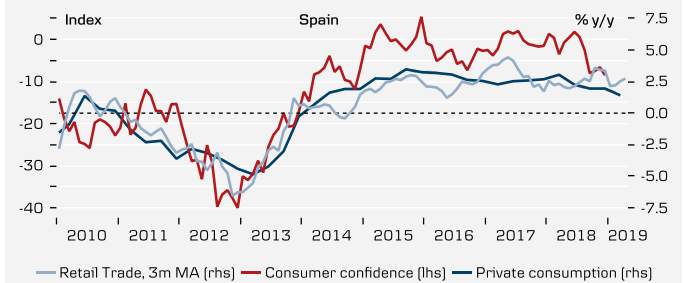
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Housing prices and construction activity



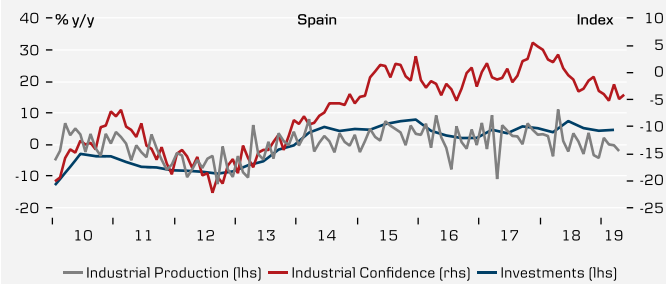
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Consumer confidence and private consumption



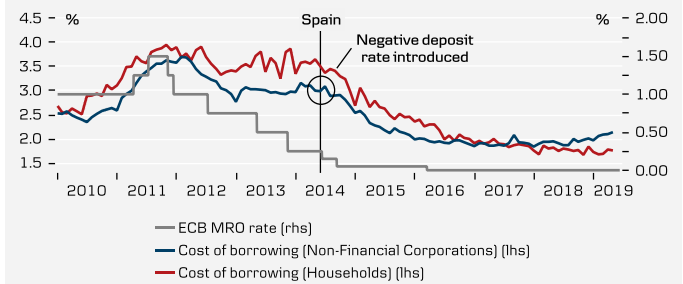
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Industrial production and investments



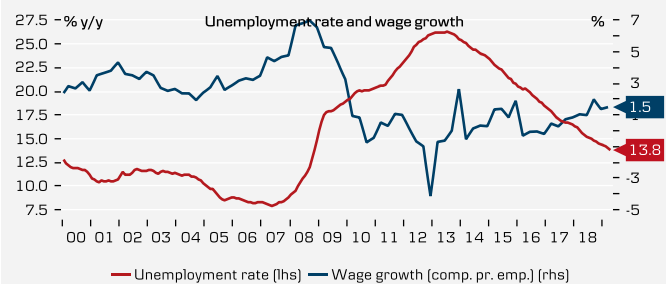
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Borrowing costs



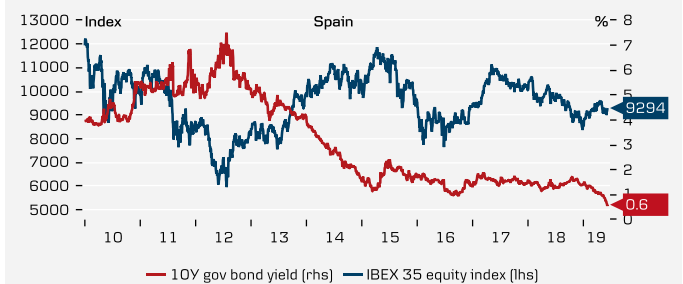
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Unemployment and wage growth



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 (Senior Analyst) and Rune Thyge Johansen (Assistant Analyst).

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Date of first publication

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