Global Economy

How much will Europe's economy slow down?

Expansión

Miguel Jiménez

The strong downward revision of economic forecasts published by the European Commission last week had a substantial impact on the financial markets, leading to questions about whether the evident slowdown that we are currently experiencing could be more serious than previously thought and culminate in some kind of recession. The EC reduced its growth forecast for this year from 1.9% to 1.3%. While this appears to be a considerable change in just three months and resemble a total overhaul of the EC's outlook rather than a technical adjustment, its previous estimates were too optimistic as a result of the momentum carried over from 2017, which was an exceptionally positive year. The EC also published a growth projection of 0.2% for Italy this year (one point below its autumn forecast). As we already know, Italy has been in a technical recession since the second half of 2018 and represents a highly sensitive issue for markets, given its high level of public debt and the tendency of the current government's leaders to make investors nervous.

The EC's doubts are closely aligned with the widespread pessimism about the global economy that set in at the end of 2018. Only the Federal Reserve seems to have slowed down, which again came to the rescue but through a much softer approach. However, doubts remain: How much of what we are seeing in Europe is temporary and how much is permanent? Is China's economy slowing down faster than it seems?

The unresolved trade tensions between the USA and China offer a partial explanation for the slowdown, but the negative impact could stop in the spring if, as seems likely, the two countries reach an agreement to avoid raising tariffs further. Germany's weakness in the last two quarters was not just a response to the slump in the car industry due to environmental regulations, but also to temporary slowdowns in the chemical industry, which should recover in the early part of this year. Protests in France also caused a temporary fall in consumption in an economy that otherwise seemed to be performing well. Broadly speaking, and with the exception of Italy (where problems seem to be more structural), the foundations of the eurozone remain relatively solid, thanks to employment growth, some recovery of wages, expansionary monetary and fiscal policy, and moderation of the prices of raw materials. Growth could be around 1.4% for this year and next year, as the European business cycle−considerably behind the North American cycle−has not yet been completed.

Another factor is the risk balance, which shows a clear downward trend. As well as the above-mentioned doubts about the actual trend of China's economy beyond the impact of protectionism, there are risks associated with the United States entering a recession, given the late stage of its economic cycle and the disappearance of fiscal stimulus effects, probably in 2020.

Furthermore, as has become the norm in recent years, political risks and their impact on economic confidence are the most prominent risks, especially in the eurozone. The Brexit debate has become complicated beyond belief, although it could be summarized by saying that the British government's strategy to push the options to their limit in order to get a deal approved has increased the likelihood of a chaotic departure at the end of March. Almost nobody sees this as the baseline scenario, but this is more due to blind faith in Europe's capacity to overcome obstacles in the small hours than evidence of negotiations. Political noise in Italy continues and controversy has resurfaced following the fiscal truce with Brussels, in this case concerning the independence of Italian regulators. There is also increasing concern that the forthcoming European elections will result in a more Eurosceptic and ungovernable parliament with a populist bias, which will complicate the future management of the EC. The "Europe to the rescue" approach as a definitive solution for common problems may therefore be less available in the future.

DISCLAIMER

ENQUIRIES TO:
BBVA Research: Calle Azul, 4 Edificio La Vela, Floors 4 & 5 28050 Madrid, Spain
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 25
bbvaresearch@bbva.com www.bbvaresearch.com