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Kiel Institute Economic Outlook, No. 10

Provided in Cooperation with:

Kiel Institute for the World Economy (IfW)

Suggested Citation: Boysen-Hogrefe, Jens et al. (2015) : Euro Area: Moderate Recovery proceeds, Kiel Institute Economic Outlook, No. 10, Kiel Institute for the World Economy (IfW), Kiel

This Version is available at:

<http://hdl.handle.net/10419/209478>

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Euro Area: Moderate Recovery proceeds

By Jens Boysen-Hogrefe, Salomon Fiedler, Dominik Groll, Nils Jannsen, Stefan Kooths and Ulrich Stolzenburg

Economic activity in the Euro Area is gradually gaining grip in 2015. Sentiment indicators suggest that the current - rather moderate - recovery will prevail over the second half of the year. The upswing is expected to broaden and to be increasingly driven by domestic forces. It is supported by favorable financing conditions and lower oil prices, combined with a relatively low external value of the euro.

- **We expect GDP to expand at a rate of 1.5 percent in the current year.** In the years 2016 and 2017, growth is forecast to rise to 1.7 percent and 2.0 percent, respectively.
- **Inflation will approach its target over the forecast horizon.** Consumer price inflation may dip again towards zero in the short term as a result of reduced energy costs, but is expected to rise markedly towards the end of the year. For 2016 and 2017, we expect annual inflation rates of 0.9 percent and 1.8 percent, respectively.
- **Labor markets are expected to improve further.** The current level of unemployment in the euro area of roughly 11 percent will gradually decline to an annual average of 9.9 percent in 2017. The decline in unemployment will be comparatively stronger in countries that were formerly granted financial assistance in the sovereign debt crisis, as well as in a number of eastern European countries.
- **Fiscal consolidation eases.** The expected slight reduction of budget deficits, which differ considerably between member countries, is mainly driven by favorable financial conditions and economic recovery, instead of consolidation.
- **EU investment plan is not likely to provide substantial stimulus.** According to our assessment, net effects will be rather negligible when put in perspective with macroeconomic orders of magnitude of the EU economy. Additionality of EFSI projects will only partly be fulfilled, while truly additional investments might be accompanied by a crowding-out of other investment projects, at least in countries or regions without abundant economic resources like qualified workers. Moreover, the targeted leverage ratio of 15 is uncertain and the rededication of EFSI financial resources creates opportunity costs. Regardless of the EU investment plan, which is supposed to be launched by September, we expect private investment activity to gradually increase over the forecast horizon.

Key Economic Data for the Euro Area, 2014–2017

	2014	2015	2016	2017
Real GDP ^a	0,9	1,5	1,7	2,0
without Germany ^a	0,6	1,4	1,5	1,8
Consumer prices (HICP) ^b	0,4	0,0	0,9	1,8
Unemployment rate ^c	11,6	11,0	10,5	9,9
Budget balance ^d	-2,5	-1,9	-1,9	-1,7

^aChange of real GDP in percent. — ^bChange over previous year in percent. — ^cIn percent of labor force. — ^dPercent of nominal GDP. — Shaded: IfW forecast.

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