Focus

19 december

'Mountain goats leave behind European black sheep'

'Compared to other countries, the European economy is still treading water as it is unable to sufficiently benefit from a resurgence in the world economy.'

In its latest World Economic Outlook, the IMF says global economic growth is in a synchronised slowdown. Real economic growth in 2019 is indeed disappointing, which seems to be a global trend. At the same time, the IMF emphasises that the global economy will resurge in 2020, which would mean the slowdown in growth in 2019 was only temporary, the main causes being international trade tensions, Brexit and an increase in protectionism. 2020 therefore promises to be a year of strong economic recovery, with a marked recovery in Europe in particular.

Europe is Treading Water

KBC Economics shares this vision for the global economy as a whole, but not for the European economy. Our own analyses show that a strong recovery of the European economy is unlikely, which means that growth in Europe will remain weak in 2020. We expect that growth will remain at its current rate, not only in 2020, but also in subsequent years, showing slight recovery. This implies a stabilisation of growth or a slowly rippling European economy with little movement. This basic scenario is also vulnerable to major economic shocks, especially from an international perspective. Since, compared to other countries, the European economy is still treading water and its performance is relatively weak, Europe will be unable to sufficiently benefit from a resurgence in the world economy due to a number of reasons.

Protectionism

Europe's weak performance can be largely attributed to its vulnerability to protectionism. We have noticed a global structural trend of increasing protectionism which is only partially offset by new trade agreements and other integration initiatives. Even when Europe is not directly involved in trade disputes, it is often the biggest victim. This is something we already noticed in the US-China trade war, which is clearly leaving its mark on Europe in the form of declining export growth and increasing import competition (especially from China). As a result of the combination of weak (or even negative) export growth and continued strong import growth, the contribution of net exports to European growth will remain under pressure in the coming years. The strong import growth is partially due to the overall strong domestic economic performance of most European economies. Further job creation and wage growth support domestic consumption and, by extension, the import of foreign products and services.

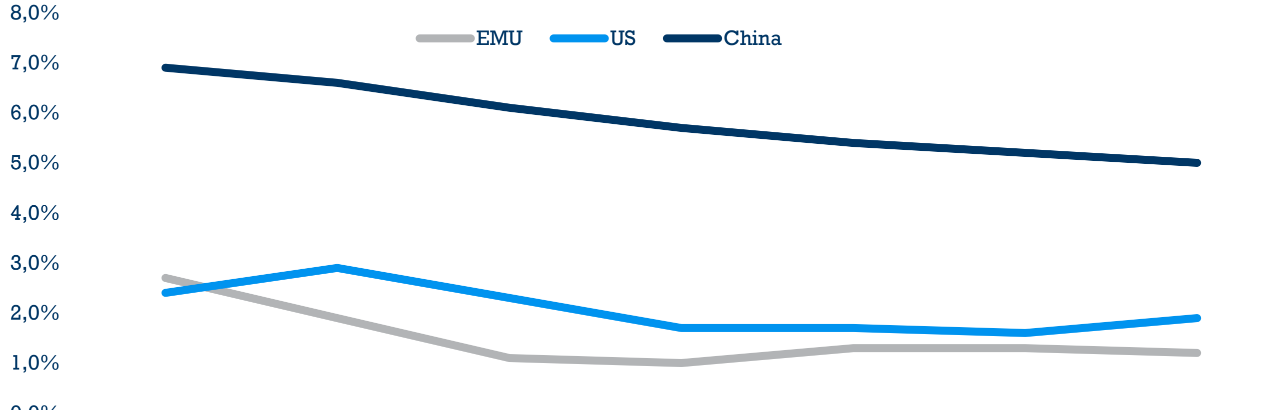
Brexit

Brexit will continue to cause problems for the European economy in the coming years. Even an orderly resolution of Britain's divorce from the EU and a new integration agreement for the future will not prevent the European economy from suffering from the more fragile relationship with an important economic partner.

Slowdown in Growth

Our key trade partners will endure a slowdown in growth in the coming years. The US economy, in particular, will find itself in a late-cyclical phase. Nevertheless, we expect that the US economy will continue to perform well and, in absolute terms, well above the European growth rate. Chinese economic growth will also continue to slow down, but again at much higher growth rates than the European economy.

Recent and expected annual
real GDP growth (%)
(Source: KBC Economics)



	2017	2018	2019 (est.)	2020 (est.)	2021 (est.)	2022 (est.)	2023 (est.)
EMU	2,7	1,9	1,1	1	1,3	1,3	1,2
US	2,4	2,9	2,3	1,7	1,7	1,6	1,9
China	6,9	6,6	6,1	5,7	5,4	5,2	5

Public Finances in Crisis

We also expect European growth to come under pressure due to lack of public investment. Despite the loud calls for more financial stimulus in Europe, we don't see this happening en masse any time soon. At the European level, there's a structural lack of resources to support the European economy, and we don't expect much benefit from the new European multi-annual budget.

Investment potential at the country level also remains limited. In many countries in the euro area, the public finance situation remains critical. While more investments are urgently needed in order to increase economic growth potential in Europe, there are still substantial budgetary challenges and historically high public debt levels. This will continue to put a brake on effective public investment. In addition, countries that can afford more will refrain from investing heavily due to the shortage in their employment market and a lack of internal political consensus. In Germany in particular, we only expect prudent additional incentives from the German budget policy.

A Year of Reforms

In addition to insufficient public investment, we don't expect many institutional and economic reforms in Europe either. Due to slow economic activity, essential policy adjustments are at risk of being postponed. Europe lacks a sense of urgency. Further reforms in the employment markets, pension policy, as well as intensive innovation policy are not expected in the coming years, which is in contrast to rapid developments in other parts of the world. Completion of the European Monetary Union doesn't appear to be a priority in an economically stable environment either. Perhaps we need a new crisis before we can make significant progress in this area.

To Stand Still is to Go Backwards

We therefore expect a calm European economic climate in the coming years. While, in absolute terms, this may seem like a mediocre macroeconomic performance, compared to other countries and regions of the world, Europe is in relative decline. The lack of structural dynamics poses a threat to long-term European prosperity. International shocks or even a traditional global economic downturn will hit the European economy hard again in the future. In the longer term, Europe therefore risks falling victim to its own complacency.

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