



Economic Assessment of the Euro Area

Winter 2018/2019

January 2019



EUROFRAME

European Forecasting Research
Association for the Macro-Economy

CPB - [Netherlands Bureau for Economic Policy Analysis \(The Hague\)](#)



DIW Berlin - [German Institute for Economic Research \(Berlin\)](#)



ESRI - [The Economic and Social Research Institute \(Dublin\)](#)



ETLA - [The Research Institute of the Finnish Economy \(Helsinki\)](#)



IfW - [The Kiel Institute for the World Economy \(Kiel\)](#)



NIESR - [The National Institute for Economic and Social Research \(London\)](#)



OFCE - [Observatoire Français des Conjonctures Economiques \(Paris\)](#)



PROMETEIA - [Associazione per le previsioni econometriche \(Bologna\)](#)



WIFO - [Austrian Institute of Economic Research \(Vienna\)](#)



CASE - [Center for Social and Economic Research \(Warsaw\)](#)



Economic Assessment of the Euro Area: Winter 2018/2019

This Euroframe Report presents an assessment of the economic outlook for 2019 and 2020 focused on the euro area based on a synopsis of the forecasts of Euroframe institutes. Perspectives for UK and CEEs countries are described in Boxes A and B respectively.

In the Focus section, we discuss a special topic, based on work done in the Euroframe institutes. This time, against the backdrop of the progressing recovery, we discuss the evolution of wage growth in Europe, highlighting countries peculiarities.

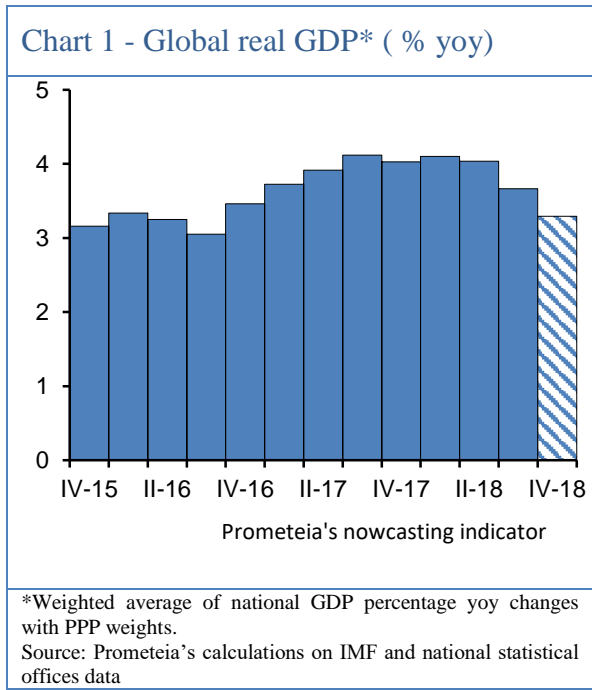
The international outlook: decelerating global growth amid increasing uncertainty

World growth is losing momentum. The tightening of monetary policy in the US, the intensifying global trade disputes and the depreciation of the Chinese renminbi contributed to the progressive deceleration of the global economy in 2018 (Chart 1) and brought to light risks that threaten global prospective growth. Overall, the continuous worsening climate of confidence is anticipating a weak start for 2019.

Global financial conditions are tightening. Increasing US interest rates contributed to strengthen the dollar, putting pressures on several emerging countries, especially those highly indebted in foreign currencies. In order to limit capital outflows and the depreciation of the national currency, since summer 2018 many countries have increased monetary policy interest rates. In addition, on December

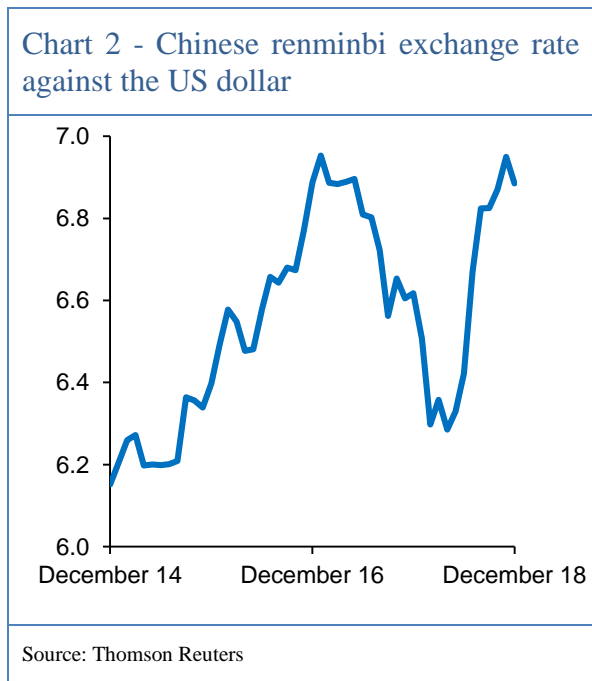
2018, the ECB concluded its QE and the Fed is likely to continue to reduce its portfolio assets despite the recent declared more cautious attitude towards normalizing monetary policy that could result in the stability of the federal funds rates at the present levels.

Signs of growth deceleration in the US... The US economic cycle is approaching being one of the longest on record, but several factors will contribute to reduce the pace of growth. The shutdown of several public offices at the beginning of 2019 is likely to drag on growth in the first quarter. At current law, some fiscal measures will fade in the following months and are not likely to be offset by additional impulses given the political deployment at the Congress. Non-financial corporation debt is high, signalling an increase in specific financial fragilities for some US corporations



and new episodes of volatility resulting in fall in share prices cannot be excluded.

... and in China as well. In China, trade confrontation with US is eating into growth. The expansionary measures adopted since July 2018 suggest a more fragile outlook than that implicit in the deceleration on course. China weakness could further jeopardize the stability



of the national currency that since July 2018 has depreciated by roughly 8 per cent against the dollar (Chart 2), despite the sale of reserves by the PBoC. The weakness of the Chinese renminbi could easily exacerbate the competitive tensions with trade partners paving the way to further reductions of trade growth.

Prospects in summary. Overall, in 2019, both China and the US are expected to decelerate with inevitable negative effects on the global economy.

Individual projections across EUROFRAME institutes are fairly homogenous and assumptions differ only to a limited extent. With fiscal stimulus gradually fading out and further tightening of monetary policy the US economic growth is expected to continuously lose pace with growth rates of 2.5 percent (on average) and 1.8 percent this and next year. The institutes project the exchange rate to stay at around 1.15 US-Dollar/EURO throughout the forecast horizon. Assumptions on the development of oil prices reveal more prominent differences across institutes. However, the majority of institutes assumes that Brent oil prices will decline from 73 US-Dollar per barrel last year to around 69 this year and broadly stabilize at this price thereafter.

Risks are mainly on the downside. The risk of a deep deceleration worldwide remains high as long as the development of the trade disputes remains unclear and the prospects of China continue to deteriorate.

The Euro Area Outlook: Decelerating growth and rising uncertainties

Euro area GDP growth decelerated in 2018 more than expected. While euro area GDP growth had remained strong throughout 2017 and peaked at 2.8 per cent in the second half of the year as compared to a year before, economic activity lost steam in the first half of 2018 and decelerated further from quarterly growth rates of 0.4 percent in the first two quarters to 0.2 percent in the third quarter of last year. Euro area GDP will have decelerated from an annual 2.5 percent in 2017 to 1.9 percent in 2018, more rapidly than expected by most forecasters, including last year's EUROFRAME Economic Assessment of the Euro Area, when we expected euro area GDP growth to reach 2.3 per cent in 2018. In 2018, GDP growth deceleration was amplified by temporary factors like the implementation of WLTP which contributed to a fall in German GDP in the third quarter (-0.2 in the third quarter, after +0.5 in the second quarter), by tax increases in France which contributed to dampen households' consumption in the first half of the year, and by increasing policy uncertainty in Italy that has reduced household and firm confidence starting from last summer.

Slower growth in 2019 and 2020... Based on business survey data up to December, the EUROFRAME [Euro Growth Indicator](#) suggests that underlying growth dynamics continued to weaken in the last quarter of the year which is in line with weak industrial production growth last October and November. [Euro Growth Indicator](#) also suggests that economic growth in the euro area will remain at around 0.3 per cent in the first quarter of 2019. This is in line with the EUROFRAME institutes' forecasts, expecting a further

slowdown, albeit a moderate one, of GDP growth this year.

... basing on less favourable external scenario... As far as expectations on the external environment, EUROFRAME institutes have similar assumptions. As oil prices are projected to remain below 70 dollars this year and next, against 73 last year, and under stable exchange rates, euro area consumer price inflation is expected to slightly decline from 1.8 percent in 2018 to 1.6 percent this year and next. The institutes assume that the ECB keeps its course to gradually end unconventionally monetary measures and zero interest rate policy by the end of the year. On average the refinancing rate is projected to increase to 0.2 percent by the end of this year and 0.6 percent in 2020.

... and notwithstanding a still favourable domestic context. The slight but gradual deceleration of the world economy together with a less expansionary monetary policy diminish the prospects of strong economic growth in the euro area. Slowly declining capacity utilization at the euro area level (from a high level of close to 84 per cent), decelerating industrial production, and downward pointing business sentiment indicators weaken the short-term outlook for investment. Consumer expenditure is supported by continuously improving labour market conditions with job creation and increasing wages, in countries where unemployment rates are already low (see our Focus), whereby consumer price inflation is projected to remain subdued. Private consumption together with a mildly

expansionary fiscal policy stance is expected to foster economic growth in the euro area.

Downside risks on the rise. The downside risks for the euro area economy seem to have increased in recent months. Further escalations of the international trade conflicts, the uncertainties around Brexit (and the risk of a no deal by end March, see Box A), might dampen investment activities and, hence, economic growth in the euro area in the coming months.

In summary. Overall, the euro area economy is expected to moderately slowdown further with growth rates of 1.6 percent in 2019 and 1.5 percent in 2020. Labour market conditions will improve further as unemployment continues to decline, however, at a slower pace than in the last years. The EUROFRAME institutes project euro area unemployment rates to be 7.8 percent this year and 7.6 percent in 2020. Consumer price inflation is expected to remain at around 1.6 percent., remaining below the inflation target of the European Central Bank.

Table 1 - Euro Area Forecasts - Euroframe Institute's average

GDP			CPI Inflation*			Unemployment Rate**		
2018	2019	2020	2018	2019	2020	2018	2019	2020
1.9	1.6	1.5	1.8	1.6	1.6	8.2	7.8	7.6

* HICP
** Eurostat definition

Table 2 - Euro Area Forecasts

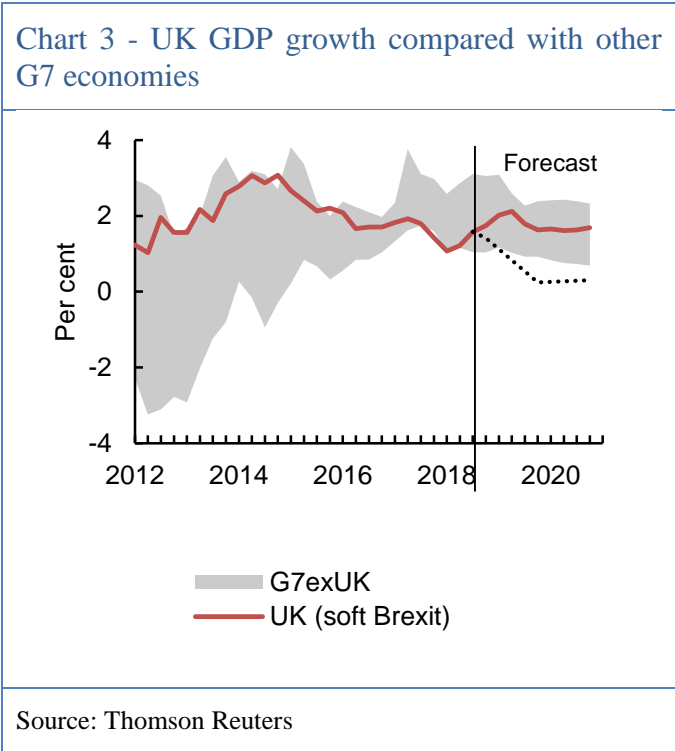
Institute	GDP			CPI Inflation*			Unemployment Rate**			Date of forecast
	2018	2019	2020	2018	2019	2020	2018	2019	2020	
Wifo	2.0	1.7	1.8	-	-	-	-	-	-	12/2018
ETLA	1.8	1.4	1.5	1.7	1.6	1.7	8.2	7.8	7.6	12/2018
OFCE	2.0	1.8	1.6	1.7	1.6	1.5	8.3	7.8	7.5	10/2018
DIW	1.8	1.7	1.5	1.9	1.8	1.7	8.3	7.8	7.5	12/2018
IfW	1.9	1.7	1.5	1.7	1.5	1.5	8.2	7.7	7.4	12/2018
Prometeia	1.9	1.2	1.3	1.7	1.5	1.2	8.0	7.7	7.5	12/2018
CPB	2.0	1.7	-	1.8	1.4	-	-	-	-	12/2018
NIESR	2.1	2.0	1.6	1.8	1.8	1.8	8.2	7.8	7.9	11/2018

* HICP
** Eurostat definition

BOX A: UK prospects

UK economic prospects are closely tied to its future relationship with European Union. With less than three months to go and in spite of the UK and EU agreed on a deal, there is little clarity of that relationship. The entire spectrum of possibilities, ranging from a no-deal, where the UK exits in a disorderly way, to staying in the EU, remains alive.

It is against this backdrop that UK economic growth is expected to have slowed in 2018 to 1.4 per cent from 1.7 per cent in the previous year. The UK has turned from being one of the top performers among the G7 up until 2016 to one of the weakest since the EU referendum (Chart 3). Over this period, CPI inflation, the measure that is targeted by the Bank of England, rose from levels well below the target rate of 2 per cent to well above. The jump is largely attributable to the 16 per cent depreciation of sterling which is largely driven by the EU referendum.



Our central forecast for the UK economy, published in November⁽¹⁾, assumes a soft Brexit. By soft Brexit we mean a future relationship where both sides enjoy frictionless access to each other’s markets for goods and services and an orderly functioning of financial markets. Under that scenario, GDP growth rises to 1.9 per cent this year. The risk to the central case is skewed to the downside mainly because of alternative Brexit outcomes, all of which will be less favourable to UK GDP growth prospects.

News since we published these forecasts also suggests that short term growth prospects are somewhat weaker-than-expected. Data from the ONS as well as business surveys point to quarterly economic growth in the final quarter of last

year to just 0.6 per cent, down from 0.3 per cent in the third quarter. This, along with back data history, will nudge lower the estimate for 2018 from the 1.4 per cent that we published in November to around 1.3 per cent and a similar adjustment for 2019.

If instead of the soft Brexit baseline scenario, the UK ends up with a hard Brexit, the economy will slow sharply in 2019 and inflation will rise again because of the depreciation of the currency. In this case, the UK will continue to underperform the G7.

(1) Hantzsche, A, Kara, A and Young, G: Prospects for the UK Economy. *National Institute Economic Review* No. 246 November 2018.

BOX B: CEECs prospects

Central and Eastern European Countries (CEECs) recorded fast economic growth in 2018. Region's largest economy, Poland, was the top performer. Real GDP growth after the first three quarters amounted to over 5 per cent, and the result will likely be maintained in the course of the entire year. Other strong performers, with expected growth rate over 4 per cent, were Slovenia, Hungary, and Latvia. As a result, unemployment fell in 2018 throughout the entire region. In Poland, the unemployment rate decreased to a record low 3.8 per cent (LFS) and nominal average salary increased by 7.1 per cent. However, the lowest unemployment rate was recorded at 1.9% in the Czech Republic in November 2018. Household consumption was the main driver of economic growth in the region. Another contributor to GDP growth was investment, especially public, financed from the EU funds. Despite increasing wages, CPI stabilized on moderate levels in the CEECs with the notable exception of Romania where price dynamics accelerated significantly. In Poland, CPI grew by less than 2 per cent throughout the entire year, which is below the central bank's target of 2.5 per cent. Thanks to the growing economy and increasing tax compliance Polish general government deficit in 2018 is expected to be historically low and reach roughly 0.5 per cent of GDP. Due to the slowing world economy and exhausting reserves of qualified workforce, GDP growth is expected to decelerate in the region in 2019. Private consumption will likely remain the main driver of economic growth not only in Poland. We expect that the growth of the Polish economy will slow down in 2019 by 1.5 pp. (to 3.5 per cent). A significant risk factor to the prospects of the economy is a potential outflow of Ukrainian workers, as they may decide to move to Germany after the German government opened the labour market to them.

Table 3 - Individual Country Forecasts

Country	GDP growth (%) ^a			CPI Inflation (HICP) (%)			Unemployment Rate (Eurostat definition, %)			Date of forecast
	2018	2019	2020	2018	2019	2020	2018	2019	2020	
Austria (WIFO)**	2.7	2.0	1.8	2.1	2.1	2.0	4.9	4.6	4.6	12/2018
Finland (ETLA)	2.5	1.5	1.5	1.1	1.4	1.8	7.7	7.4	7.1	12/2018
France (OFCE)	1.7	1.8	1.5	2.1	1.7	1.7	8.8	8.5	8.4	10/2018
Germany (DIW)	1.5	1.6	1.8	1.9	2.0	2.0	5.2	4.8	4.5	12/2018
Germany (IfW)	1.5	1.9	1.5	1.9	1.8	1.7	3.4	3.1	3.0	12/2018
Italy (Prometeia)	0.9	0.5	0.7	1.2	0.9	1.1	10.5	10.5	10.3	12/2018
Ireland (ESRI)	8.2	4.2	-	0.6	1.1	-	5.7	5.1	-	12/2018
Netherlands (CPB)	2.6	2.2	-	1.6	2.4	-	3.9	3.6	-	12/2018
Poland (Case)	5.0	3.5	3.0	1.2	3.0	2.8	3.3	2.8	2.7	12/2018
United Kingdom (NIESR)	1.4	1.9	1.6	2.5	2.1	2	3.9	3.8	3.9	11/2018

^a working day adjusted

** not working day adjusted

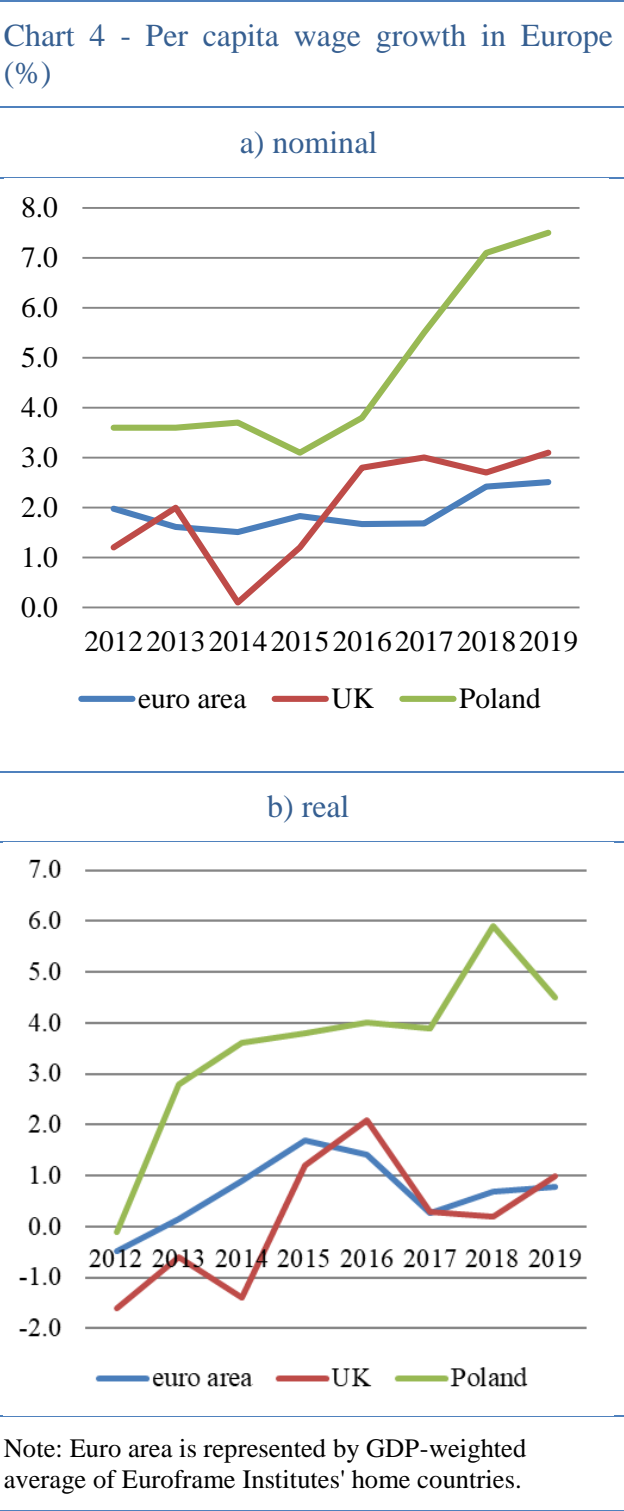
Focus: Broad-base acceleration of nominal wage growth in Europe

Overview

The Great Recession and the European sovereign debt crises led to a number of years of pronounced weakness in wage growth. Between 2012 and 2017, developments in the home countries of the EUROFRAME member institutes (which represent close to 80 per cent of the total euro area economy) indicate that gross wages and salaries in the euro area increased by little more than 1.5 per cent. However, more recently the progressive economic recovery and falling unemployment have started to be reflected in stronger nominal wage growth, which is estimated to have risen to around 2.5 per cent in 2018 and should remain close to that level in 2019 (Chart 4 and Table 4). In real terms wage growth at the euro area level is expected to be close to long run averages although below the rates seen in 2015/16, when CPI inflation was depressed by falling oil prices.

The acceleration of wages is broad based, but differs across countries depending on their position in the cycle. It is most visible in countries that have experienced a prolonged expansion and where unemployment is relatively low, such as in Germany, and less pronounced in countries where unemployment is still elevated and economic momentum is relatively weak, including France and in particular Italy (Table 4).

Nominal wage growth is on a rising trend also in most European countries outside the euro area, reflecting robust employment



growth and falling unemployment. A case in point is Poland where employment expanded by 3.5 per cent last year and unemployment fell to a historically low rate of 5.5 percent while wage growth increased to 7.1 per cent in 2018 and is expected to accelerate further to 7.5 per cent this year. Nominal wage growth in the United Kingdom strengthened already in

2016 and continued at around 3 per cent since then, i.e. 1 per cent in real terms, despite low productivity growth and the uncertainty around Brexit. However, real wages are only catching up with their pre-crisis levels. Nominal wage growth is projected to remain robust going forward.

Table 4 - Gross Wages and Salaries per head (change over previous year in percent)

a) nominal								
	2012	2013	2014	2015	2016	2017	2018 ^e	2019 ^e
Austria	2.7	1.9	1.7	2.0	2.3	1.4	2.4	2.6
Finland	3.3	2.0	1.5	1.4	0.9	0.2	1.9	2.3
France	2.0	1.5	0.8	1.1	1.3	1.8	2.0	2.3
Germany	2.7	2.1	2.8	2.8	2.4	2.5	3.2	3.3
Ireland	1.0	-0.8	0.6	2.8	2.5	1.5	2.6	2.9
Italy	0.6	1.4	0.3	1.1	0.7	0.3	1.7	1.1
The Netherlands	1.6	1.2	1.0	1.2	1.5	1.6	2.0	2.8
Euro area	2.0	1.6	1.5	1.8	1.7	1.7	2.4	2.5
Poland	3.6	3.6	3.7	3.1	3.8	5.5	7.1	7.5
United Kingdom	1.2	2.0	0.1	1.2	2.8	3.0	2.7	3.1

b) real										
	Real gross wages per head (change over previous year in percent)								Real wage growth	Productivity per head (a)
	2012	2013	2014	2015	2016	2017	2018 ^e	2019 ^e	2018/2014 annual average growth (b)	
Austria	0.1	-0.2	0.2	1.2	1.3	-0.8	0.3	0.5	0.5	0.8
Finland	0.1	-0.2	0.3	1.6	0.5	-0.6	0.8	0.9	0.6	1.1
France	-0.2	0.5	0.2	1.0	1.0	0.6	0.0	0.6	0.6	0.9
Germany	0.6	0.5	2.0	2.7	2.0	0.8	1.3	1.4	1.7	0.7
Ireland	-0.9	-1.3	0.3	2.8	2.7	1.2	1.9	1.8	2.2	3.4
Italy	-2.8	0.2	0.1	1.0	0.8	-1.0	0.5	0.2	0.3	0.2
The Netherlands	-1.2	-1.4	0.7	1.0	1.4	0.3	0.4	0.3	0.8	0.8
Euro area	-0.5	0.2	0.9	1.7	1.4	0.3	0.7	0.8	1.0	0.7
Poland	-0.1	2.8	3.6	3.8	4.0	3.9	5.9	4.9	4.4	3.2
United Kingdom	-1.6	-0.6	-1.4	1.2	2.1	0.3	0.2	1.0	1.0	0.6

Notes: Figures for Italy refer to gross salary in the total economy, figures for the Netherlands to negotiated wages per hour. — e: expected by Euroframe Institutes. Forecast for Germany is average of DIW and IfW forecasts. — Euro area refers to the GDP weighted average of the listed euro area member countries which represent almost 80% of the total euro area economy. — Real wage calculated as rate of increase in nominal wages minus HICP inflation rate. (a) Gross domestic product at 2010 reference levels per person employed (source: AMECO) (b) Except Productivity per head for Ireland: 2018/2015 average.

Country Details

Austria

Nominal wage growth is solid in Austria, while real net wage growth is more modest.

According to current estimates, gross wages and salaries increased by 4.7 percent in 2018, significantly up from +3.4 percent in 2017, thanks to rising employment and higher wage settlements. On a per-capita basis, nominal wages and salaries grew by 2.4 percent in 2018, and thus more strongly than one year earlier (+1.4 percent). For 2019, the nominal increase of wages and salaries is expected to remain robust and even accelerate slightly. In autumn 2018, collective bargaining rounds reached settlements that were 0.3 to 0.4 percentage points higher than in the previous year. Despite a good nominal performance, net real wages after inflation and tax per-capita increased only slightly in 2018. Because of a reduced tax burden in 2019, net real wage gains are expected to grow with a stronger pace in 2019. The solid wage trend enables a robust increase in private consumption, supporting economic growth in Austria 2018 and 2019. Considering the industrial sector, the expected wage development will cause a mild upward pressure on prices in the sector from 2019 onwards.

Finland

The nominal earnings increased only by 0.2 per cent in Finland in 2017. The modest development can be explained by the so called “competitiveness pact”, a deal negotiated in 2016 between trade unions and employers’ organizations and supported by the government, to improve the competitiveness of the Finnish export sector. In the first three quarters of 2018, the wage growth was still dragged down by the competitiveness pact: in the private sector, earnings increased by 1.7

per cent whereas in the public sector earnings increased by between 1.2 and 1.3 per cent.

ETLA expects that total increase in nominal earnings would be 1.9 per cent in 2018.

Together with the increase in employment, this would convert into 4.7 per cent increase in gross wages for 2018. The real earnings are forecast to rise by 0.8 per cent.

For this year, the earnings are supported by the good development in domestic demand and employment. This should be reflected in an increase in wage drift, the component which fluctuates while the pay rises are also tied to the old, previously made contracts. As a result, the earnings are expected to rise by 2.3 per cent and wage sum by 3.6 per cent this year. Despite an expected slowing down of GDP growth in Finland in 2019 and 2020, the wage growth is forecast to accelerate again in 2020. This is, however, to a great extent due to a mechanical wage increase in the public sector, where temporary cuts in earnings expire in 2020. All in all, the nominal earnings are forecast to rise by 2.9 per cent and gross wages and salaries by 4.0 per cent in 2020. The real wages are forecast to rise by 0.9 and 1.1 per cent in 2019 and 2020, respectively. Real wages would also grow in line with labour productivity.

France

French GDP growth was weak from mid-2012 to mid-2016 when the unemployment rate remained above 10 per cent. Wage growth remained subdued; wages grew in line with minimum wage growth and past inflation. From mid-2013 to mid-2016 consumer price deceleration had a positive impact on real wage growth; while price acceleration had the opposite effect in 2017 and 2018. Over the past two years, French GDP growth was more

robust, with job creation and a slow decrease in the unemployment rate (still at 8.9 per cent in November 2018). Over the past six years, real wages rose by 4.15 per cent, the real minimum wage by 2.65 per cent, labour productivity grew by 3.9 per cent.

Despite job creation and a decrease in unemployment, difficulties to hire workers as stated by companies, wage growth did not accelerate in recent months. This may be due to the low increase in the minimum wage, the number of under-employed (discouraged unemployed, constrained part time), to the bargaining power between employees and employers at company level. In 2018, workers' purchasing power increased with the abolition of employees' social contributions (3.15 percentage points) replaced by a 1.7 percentage point rise in the CSG (Contribution sociale généralisée), which may also have limited demands for pay increase. Nominal wages were 2.1 per cent higher in the third quarter of 2018 than a year before. In January 2019, the minimum wage increased by 1.5 per cent only, but low-wage workers benefited from a strong increase in the Prime d'activité (social benefit for low-paid workers families +7% of their take-home wages).

Nominal wage growth would slightly accelerate to close to 2.5 per cent by the end of 2019. With consumer price inflation expected to rise by around 1.5 per cent, real wages would grow by less than 1 per cent, in line with labour productivity.

Germany

As a result of the long-lasting upswing on the German labour market, the standardized unemployment rate has dropped to a post-unification low of 3.4 per cent and the tightness on the labour market has become more and more visible. Both the number of posted vacancies per unemployed person and the number of days an open position remains vacant have been hitting all-time highs (in unified Germany). The same is true for the

number of firms that, according to business surveys, view labour as a limit to production or as the most important risk to their business activities. Against this backdrop, both nominal and real gross wages and salaries per employee have been rising with above-average rates since 2010 with the growth rate of effective wages exceeding the growth rate of collectively agreed wages. The wage drift, however, has been contained by marked increases in labour market participation, in particular by women and the "50+"-age cohorts, as well as substantial EU-migration inflows. Also, labour unions' focus on improving working conditions took some pressure off the wage increases.

In 2018, negotiated wages and salaries have accelerated markedly to an estimated 2.8 percent on average, following 2.1 percent in 2017. In 2019, the wages will continue to rise swiftly, although the pattern of wage contracts in manufacturing and construction and a likely response in the upcoming negotiations to the shift of health insurance contributions from employees to employers, which became effective in January this year, suggest that the rate of growth in contractual wages may slow slightly to 2.6 percent. Nevertheless, growth of effective gross wages should remain at 3.2 percent: labour market conditions will ease only gradually, despite substantial increases in unit labour costs dampening the demand for labour going forward. In addition, we expect continued upward pressure on average hours worked, partly due to overtime, boosting effective earnings per employee.

Ireland

Real wages in Ireland are expected to grow on average by 2 per cent in 2018, following considerable labour demand in the ICT and construction sectors. Seasonally-adjusted average hourly earnings in Q3 2018 increased to €23.05 per hour with average growth over the past four quarters of 2.7 per cent. The largest rolling average growth for the quarter was observed in information and

communication activities, rising annually by 6.2 per cent. High growth was also apparent in similarly high skilled sectors including financial, insurance and real estate activities (+4.1 per cent) and professional, scientific and technical activities (+4.2 per cent). These nominal earnings have persistently trended upwards since the end of 2015 in a domestic environment of near-zero inflation rates. As of Q3 2018, average weekly earnings reached €742.41, representing a four-quarter rolling average rise of 2.9 per cent.

As of Q3 2018, public sector average weekly earnings ranged from €827.67 among regional bodies to €1,325.13 per week for the police force. Average private sector earnings ranged from €354.48 per week in accommodation and food service activities to €1,168.10 per week in ICT activities. Across both the public and private sectors, nominal wage growth remains broad-based and persistent.

Italy

The Italy's labour market has not yet regained pre-crisis levels. The unemployment rate is at 10.2 per cent (it was 6.1 per cent in 2007), and notwithstanding the employment rate reached 60.2 per cent (59.4 per cent in 2007), the full-time equivalent employees are still 1 million less than in 2007, as part-time and temporary employment increased their share on the total employment. In this context, it is not surprising that wage dynamic is still subdued. Over the recession years 2011-2014, wages increased by 0.9 per cent on the average, and decreased by -0.9 per cent in real terms. In 2018 some sign of recovery emerged, but it was mainly due to the large hikes in negotiated rates of pay in the public sector, after five years of stability due to public expenses constrained.

Labour market conditions more than institutions are likely behind this subdued development. Last year (in February) an agreement was reached between the three major trade union confederations and the Employers association (Confindustria) with the

aim of increasing the correlation of wage with productivity trends and company conditions. This agreement, although we do not expect it to change radically collective bargaining rules, is likely to continue to support a low wage dynamic, reflecting low inflation and still high unemployment. Thus, we expect wage growth in 2019-2020 to be limited on the average to 1.1 per cent in nominal terms, with an almost nil increase in purchasing power. In 2020, after the increases agreed between 2017 and 2019, the growth of public wages would come to a halt again.

The Netherlands

Due to the tighter labour market, contractual wage increases at companies will rise to 2.2 per cent next year, compared to 1.6 per cent this year. As the employment of low-skilled and start-ups increases, the incidental wage increase is zero in 2017. The incidental wage increase is expected to rise to 0.6 per cent in 2019 due to increasing competition for labour, which increases the chance of a higher scale and a favourable job change. The incidental wage increase will continue to be depressed because relatively many low-skilled people find a job. In addition to the contractual wage increase and the incidental wage increase, the salary slip looks better due to an increase in the number of hours worked per person. The occasional wage increase is also increasing in government and health care due to the increasing competition for labour. The contract wages of the government and health care follow those of the market.

Poland

Fast economic growth in 2018 (of around 5 per cent) bolstered the steep trends of falling unemployment and increasing wages in Poland. The increase in average salary amounted to 7.1 per cent, whereas the increase in employment was 3.5 per cent compared to the previous year. As a result, the official unemployment rate decreased to 5.5 per cent, which is the lowest level since November

1990. The sharp decrease in unemployment rate not only is a result of a record-high employment.

Negative demographical trends have also played an important role on the labour market. As more and more people from the post-war baby boom are retiring, less and less young people enter the labour market. This negative trend in employed population was further strengthened by the government's decision to lower the retirement age in 2015. An influx of immigrants, mainly from Ukraine, contributed substantially to filling the gaps in the labour market and slowed down the dynamics of wages among low-skilled workers. There is a danger, however, that many Ukrainians will leave the Polish labour market and move to Germany, as the German government made it easier for the workers from outside the EU to enter the labour market. Recent studies show that as many as 500,000 Ukrainians may leave the Polish labour market, making it even harder for Polish employers to find employees. If this scenario materialized, one should expect the strong wage dynamics to continue or even increase, especially among low-skilled workers.

We expect that in 2019 the wages will go up significantly faster than the overall economy for at least two more reasons. First, minimum salary was increased by 150 PLN (or 7.1 per cent) in January 2019, which is the highest increase in minimum wage since 2016, and 50 PLN more than a year earlier. Second, the dynamics of salaries in the public sector will accelerate as the government made promises of salary raise to many professional groups (e.g. policemen, office workers, doctors, firefighters), which will likely be fulfilled before the parliamentary elections in 2019.

United Kingdom

Nominal and real wage growth has risen in the UK recently. According to the latest official data, UK average weekly earnings excluding bonus payments, a measure of nominal wages, rose by 3.3 per cent in the three months to

October compared to the year before - the highest since late-2008. Real wage growth was 1 per cent over the same period – the highest rate in two years. One important driver of the acceleration in wages in the UK is public sector pay and the rise in wages for low paid workers. Our near term forecasts suggest that earnings growth will rise further to 3.5 per cent in the first quarter of this year and at the same time, we expect inflation to fall, together implying higher real wage growth.

The prospects for wages in the UK will depend on productivity growth, labour market tightness and developments in public sector pay and the minimum wage. Latest data shows that productivity on the output per hour measure expanded by just 0.2 per cent in the third quarter of last year compared with the same quarter a year ago. The UK is a notable underperformer among G7 economies. However, this weakness in productivity comes alongside a long period of rising employment and falling unemployment. The employment rate is at a post-1971 high and the unemployment rate is at a post-1975 low. Finally, public sector pay growth rose to 2.7 per cent, the fastest rate in nearly ten years. The gap between private and public sector wages had risen to unsustainable levels and the government finally lifted the cap on public sector pay that had been in place since 2010 in the 2018 Spring Budget. At the same time, the living wage (minimum wage for over 25 year olds) is set to rise by close to 5 per cent over the next two years.

Taking all these influences together, we see annual wage growth stabilise at around 3.0-3.5 per cent over the medium term as productivity growth gradually recovers to around 1.5 per cent which we consider as the stable long run level.

