



Summing up

The net result of all these forces is that we see euro area GDP growth at 1.6% in 2016, the mildest of accelerations on 2015 and consistent with our earlier views. However, the composition of growth has changed compared to earlier views. Export growth is expected to be a little slower, with indirect impacts on investment and employment. Monetary and fiscal policy will try to fill the hole left by the discontinuation of this year's oil stimulus. The biggest risk to growth in 2016 is that the joint policy effort does not replace the fading oil stimulus.

We fear 2016 will mark the peak rate of growth in this recovery and GDP growth will be slower in 2017. Oil prices pose a significant threat in 2017. Our commodity strategists expect oil prices to rise in 2017, for supply reasons, not demand. The fiscal rules are likely to bite more in 2017 than 2016. If inflation is rising, the ECB will probably not turn on the monetary spigot again either. Structural reform has been very modest, meaning little expectation for a non-cyclical recovery. The onus will increasingly be on the global recovery to compensate. Given the repeated overestimation of global growth in recent years, a stronger global economy has a lot to prove.

Euro area inflation: Normalising

Euro area inflation should recover gradually over the coming quarters as (1) the drag from lower commodity costs is assumed to progressively fade, (2) the weaker exchange rate is putting upward pressure on non-commodity import prices and (3) improving economic conditions and ECB support for expectations allow some normalisation in domestic inflation.

Point (1), above, is likely to mean that consumer energy inflation will rise quickly into 2016; under our assumptions, headline and core inflation are expected to converge by the end of 2016. Indirect effects via domestic production costs are however one factor working against a quick rise in underlying inflation.

(2) has been increasingly visible in some HICP components, with HICP durable goods inflation for example running at close to record highs in October. This should continue to exert some upward pressure on consumer prices through next year, especially on goods prices, but also on some services components, such as package holidays.

(3) Growth above trend and falling unemployment are expected to support margins and allow some rise in labour costs, while higher spot inflation and ECB policy should push up inflation expectations. In that context, domestic inflation is projected to rise, although only gradually. We see inflation close to 1% on average next year and around 1.6% in 2017.

UK: On course to a mid-year rate hike

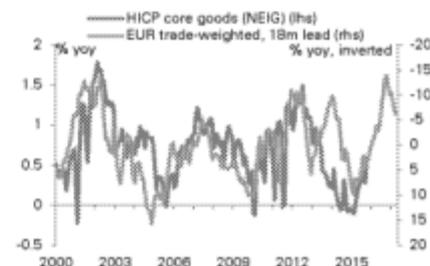
The outlook remains for GDP growth to slow to trend over 2016 and 2017. In our view, government spending will slow due to ongoing austerity and we expect investment and exports to be held back by the EU referendum and a fragile external backdrop/strong currency, respectively. Growth will likely be weighted towards consumption. Inflation should rise and undermine purchasing power, but only slowly. We expect interest rates to rise too, and household finances are more highly geared than ever. However, the slowdown in private consumption growth should be more muted thanks to robust employment growth and the capacity for households to reduce the savings rate.

Figure 11: Headline and core inflation to correct upwards in 2016



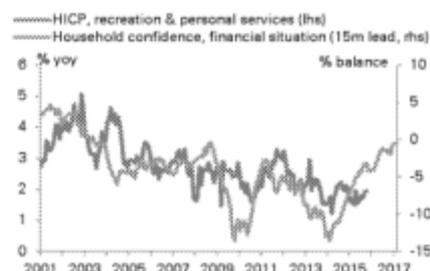
Source: Deutsche Bank Research, Eurostat

Figure 12: The inflation benefits of euro depreciation are materialising



Source: Deutsche Bank Research, ECB, Eurostat

Figure 13: Household confidence points to inflation turning point



Source: Deutsche Bank Research, Eurostat, European Commission