EUROZONE
2023-2024 OUTLOOK

SHOCK BEHIND, SHOCK AHEAD

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WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

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SUMMARY

A LASTING – AND UNEVEN – LOSS OF INCOME

The lengthy post-pandemic rebound wave is settling down, and growth normalisation is hitting another, more lasting shock from the war in Ukraine.

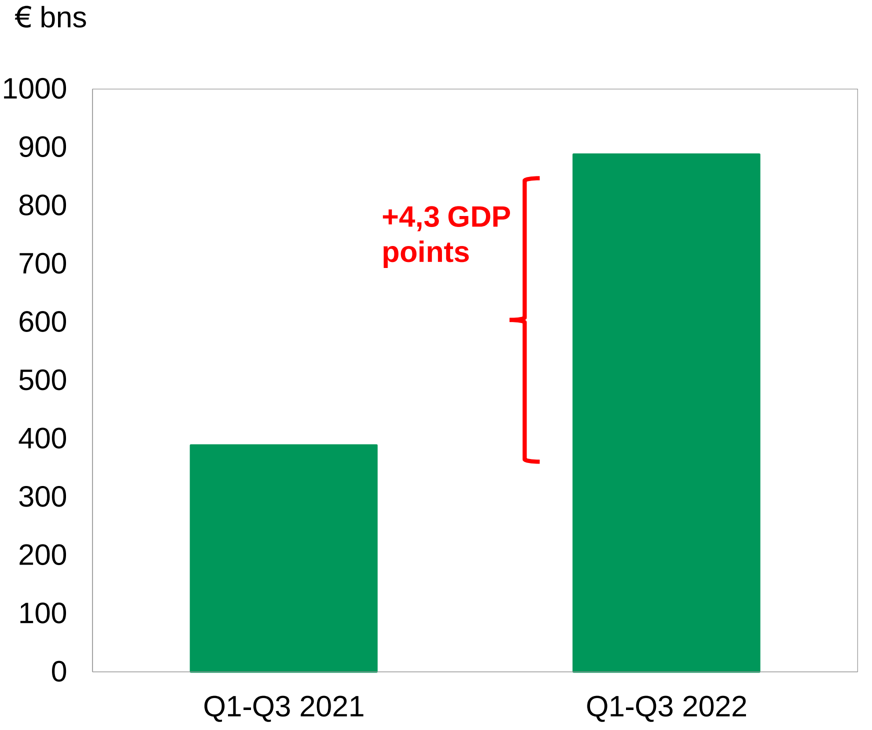
This is an exceptional slowdown for the economy: annual growth of 5.5% in Q122 fell to 2.3% in Q3. The factor of the war's impact on the cycle. With special support measures cale of this decline is not just a withdrawn, and surplus demand back to normal after having been being 'bottled up', the cycle is back to a more 'normal' magnitude. Still, this downward spiral is bigger than the Eurozone's last (non-pandemic) recession (2011-12). **Consumption, driven by substantial surplus savings, might be resilient enough to delay the contraction we expect in Q422 and Q123. The economic downturn cannot be avoided, though, and a new growth pattern threatens to be weaker for a long time** and lower than (also weaker) potential growth. **We expect GDP to grow by 0.1% in 2023 and 1.1% in 2024.**

The loss in revenue for the Eurozone economy, triggered by the rise in energy commodities prices, can be measured in the rise in the value of energy import costs over the first nine months of 2022 compared to the same period in 2021: **those extra costs amount to 4.3pt of GDP. The dynamic effects of worsening terms of trade and lost competitiveness on export volumes and market shares will gradually spread, adding to this toll.** The never-ending power bill overload in Europe is translating to a long-term downturn in business activity. Presumably, the spread of losses among economic actors can be quantified in a static framework, based on their relative energy use: 26% of losses can be attributed to households, 71% to companies and 3% to governments. But when the load is reshuffled among economic agents (government support to consumers and businesses, cost increases passed from producers to consumers, corporate profits redistributed to consumers), the distribution changes. **The behavioural changes caused by the new price signal are affecting the agents' relative losses**, as well as the total loss for the nation. While over the first eleven months of the year, **the steepest decline in natural gas consumption in Germany (-20% compared to the 2019-21 average) and Italy (-12%) goes to industry, in France it applies more to consumers (-15%).**

A POWERFUL COMPETITIVENESS SHOCK

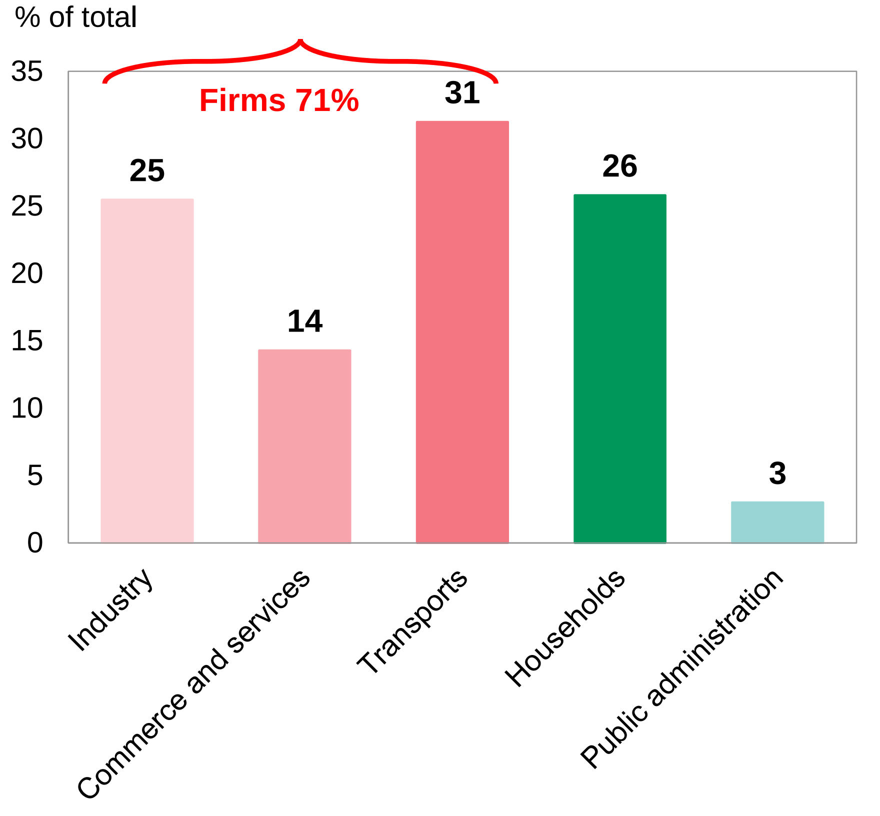
WITH COSTS UNEQUALLY DISTRIBUTED…

A competitiveness shock: increase in value of imported energy



Sources: Eurostat, Crédit Agricole SA / ECO

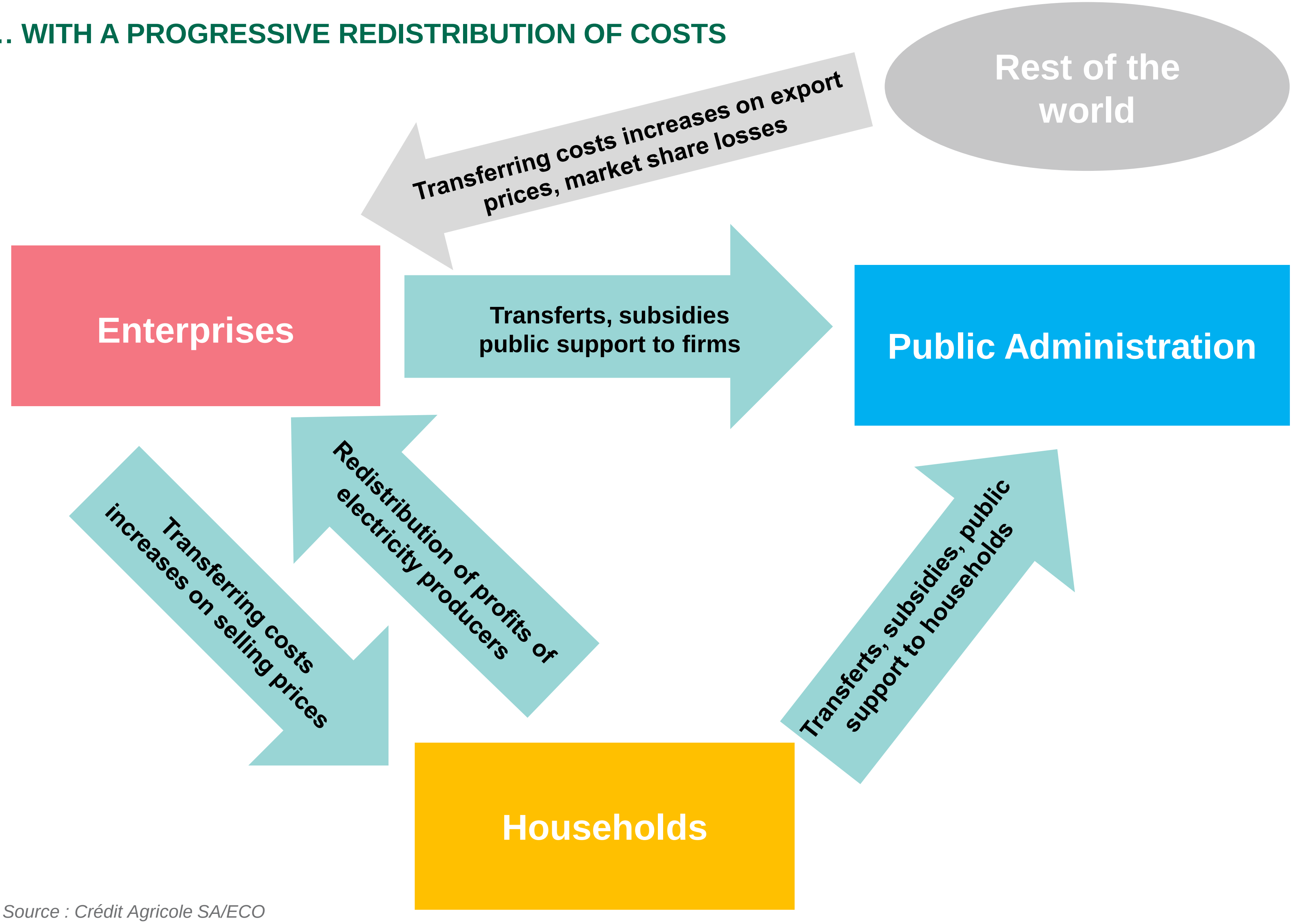
Energy final consumption by sector



Sources: Eurostat, Crédit Agricole SA / ECO

A POWERFUL COMPETITIVENESS SHOCK

… WITH A PROGRESSIVE REDISTRIBUTION OF COSTS

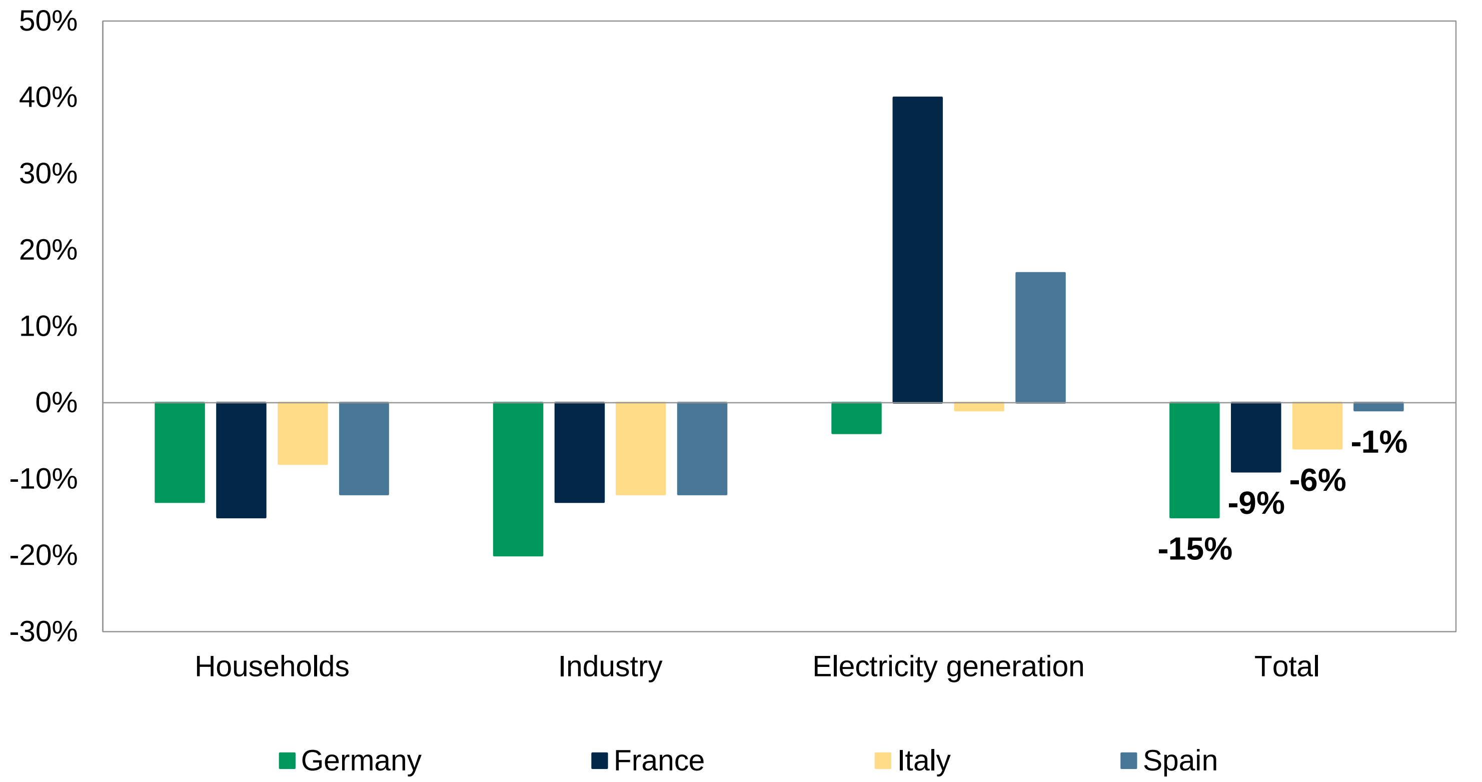


Source : Crédit Agricole SA/ECO

HIGHER PRICES LEAD TO CHANGE IN BEHAVIOUR

A FALL IN GAS CONSUMPTION IS ONGOING, OF DIFFERENT AMPLITUDE AMONG COUNTRIES AND SECTORS

Fall in gas demand
(Jan.-Nov. 2022 compared to 2019-2021 average)

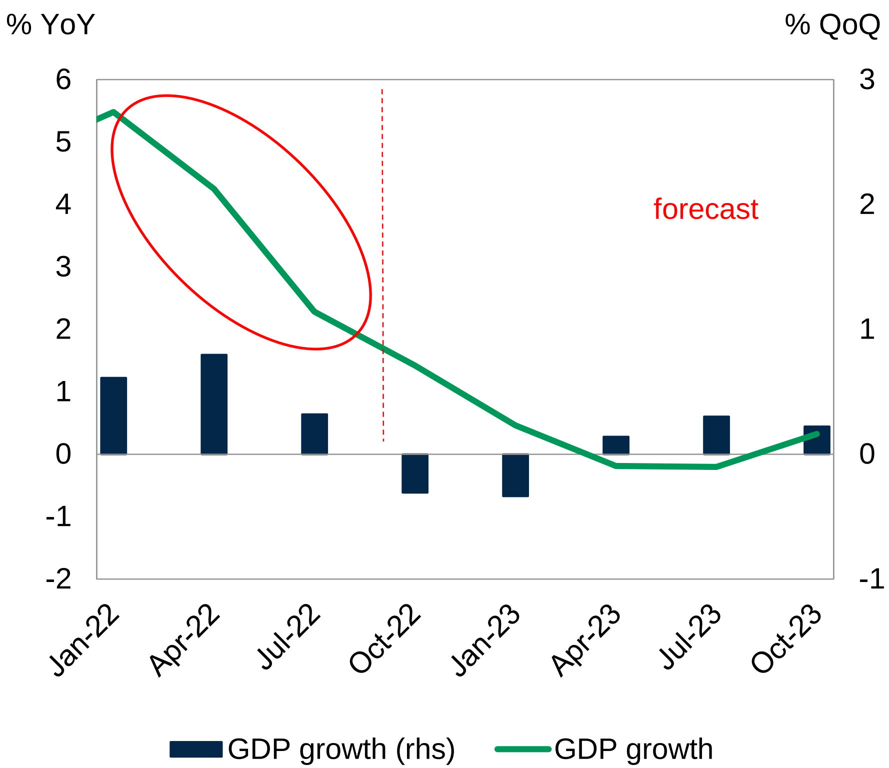


Sources: Eurostat, Crédit Agricole SA/ECO

A MARKED SLOWDOWN

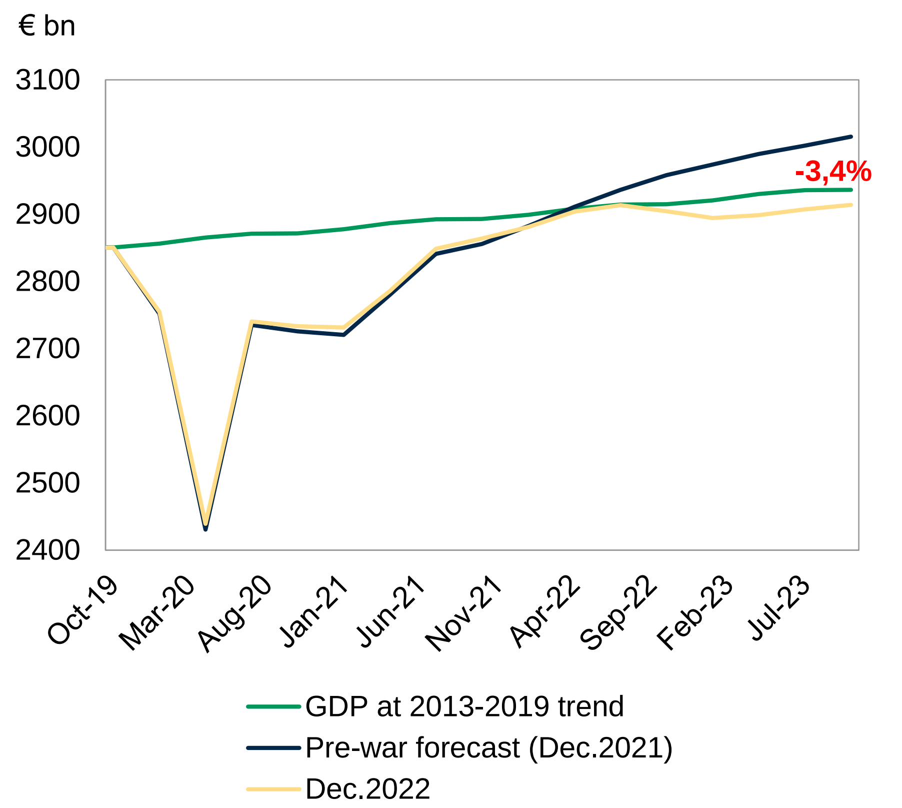
AND A NEW DURABLY LOWER GROWTH PACE

GDP growth : exceptional momentum loss



Sources: Eurostat, Crédit Agricole SA / ECO

Medium-term growth encumbered



Sources: Eurostat, Crédit Agricole SA / ECO

SUMMARY

CONTRACTION AT THE TURN OF THE YEAR, ZERO GROWTH ON AN ANNUAL AVERAGE

The post-pandemic rebound is nearly complete, with GDP exceeding its pre-COVID level by 2.2% in Q3 2022 in the Eurozone. This rebound was particularly strong in 2021 with growth of 5.3% that remained robust in 2022 at 3.3%. The post-COVID recovery was particularly rapid in 2021 in France and Italy (6.8% and 6.7%), but lost more momentum in France in 2022 (2.6%), while it remained dynamic in Italy (3.9%). These two economies have largely exceeded their pre-COVID activity levels (+1.1% for France and +1.8% for Italy). In Germany, the trough created by the pandemic has barely been filled (+0.3%) and the post-pandemic rebound has been less sustained with growth of 2.6% in 2021 and 1.8% in 2022. But the loss of GDP caused by the crisis was less, with a contraction of 4.1% compared with 7.9% in France, 9.1% in Italy and 11.3% in Spain. It is in Spain that growth will have been most sustained in 2022 (4.6% after 5.5% in 2021), but where GDP is still below its pre-pandemic level (-2%).

GDP growth in the Eurozone in Q3 2022 slowed sharply to 0.3% from 0.6% and 0.8% in Q1 and Q2 respectively. The contribution of domestic demand (0.6 percentage points p.p.) was decisive offsetting the negative contribution of net foreign demand (-0.3 p.p.). Domestic demand is supported by private consumption, which is not weakening (+0.9% q/q) and is underpinned by employment growth that is still positive (+0.3% q/q) but whose loss of dynamism is evident in annual terms (1.7% after 2.6% in Q2). Investment continued to grow (0.5%), albeit more moderately, despite the downturn in housing and construction.

GDP growth is expected to slow further in Q4 2022 and 2023. A contraction is expected in Q4 2022 (-0.3%) and Q1 2023 (-0.3%). The contraction is expected to be more pronounced in Germany (-0.6% and -0.5% in Q4 2022 and Q1 2023) and Italy (-0.1 and -0.6% respectively). In the second half of 2023, domestic demand should accelerate slightly, helped in particular by the slowdown in inflation.

On annual average, growth would be barely positive at 0.1%.This central scenario is based on strong assumptions regarding energy supply and production. The downside risks remain high, however, and in the event of forced energy rationing or further sharp price hikes, resulting in a sharper contraction in 2023.

With global gas supply still constrained and energy prices high, growth in 2024 would be limited to 1.1%. The impact of lower inflation (from 8.5% in 2022 and 7.5% in 2023 to 3.5% in 2024) on domestic demand would be partly offset by the gradual loss of competitiveness and export market share.

Main components of the scenario: Household consumption would slow with a contraction at the turn of the year and positive but modest growth thereafter. After growth of 3.7% in 2021 and 4% in 2022, private consumption is expected to be flat in 2023 and 1.2% in 2024. After having been particularly dynamic in 2021 (3.7%) and 2022 (4.2%), business investment is expected to slow in 2023 and 2024 (1.9% and 1.7%), supported nonetheless by spending linked to the European recovery plan, particularly in Italy and Spain. GDP growth is expected to be driven entirely by domestic demand, with no contribution from net exports in 2023 and 2024.The labour market is expected to remain favourably oriented. After reaching 6.6 percent in Q3 2022, the unemployment rate would begin a slow climb to an annual average of 7.2 percent in 2023 and 2024. The recovery would be limited by access to short-time working schemes in the sectors most affected by rising energy costs.

SUMMARY

CONTRACTION AT THE TURN OF THE YEAR, ZERO GROWTH ON AN ANNUAL AVERAGE

Forecast	Quarterly rate (QoQ, %)												Annual rate (YoY, %)			
EMU	2022				2023				2024				2021	2022	2023	2024
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
GDP	**0,6**	**0,8**	**0,3**	**-0,3**	**-0,3**	**0,1**	**0,3**	**0,2**	**0,3**	**0,3**	**0,3**	**0,4**	**5,3**	**3,3**	**0,1**	**1,1**
Households consumption	0,0	1,0	0,9	-0,6	-0,6	0,1	0,3	0,3	0,3	0,3	0,3	0,4	3,7	4,0	0,0	1,2
Public consumption	0,0	-0,1	0,1	0,3	0,2	0,2	0,2	0,2	0,2	0,2	0,2	0,2	4,3	1,1	0,8	0,7
Total GFCF	-0,7	0,9	3,6	-0,5	-0,2	0,3	0,4	0,4	0,5	0,4	0,4	0,5	3,7	4,2	1,9	1,7
G&S exports	1,4	1,7	1,7	0,5	0,3	0,5	0,6	0,6	0,7	0,8	0,8	0,8	10,4	7,4	2,8	2,8
G&S imports	-0,7	2,2	4,3	0,6	0,4	0,6	0,7	0,7	0,7	0,8	0,8	0,8	8,2	8,7	4,4	3,0
Inventory changes (% of GDP)	0,6	0,8	1,0	1,0	1,0	1,0	1,0	1,0	1,0	1,0	1,0	1,0	0,5	0,8	1,0	1,0
Contributions to GDP growth																
Domestic demand excluding inve	-0,2	0,7	1,3	-0,3	-0,3	0,2	0,3	0,3	0,3	0,3	0,3	0,3	3,7	3,2	0,6	1,1
Inventories	-0,3	0,2	0,2	0,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,2	0,4	0,2	0,0
Net exports	1,1	-0,1	-1,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	1,3	-0,3	-0,7	0,0
Unemployment	6,8	6,7	6,6	7,1	7,2	7,3	7,2	7,2	7,2	7,2	7,1	7,1	7,7	6,8	7,2	7,2
Consumer prices	6,1	8,0	9,3	10,6	9,5	8,7	7,6	4,9	3,8	3,0	3,3	3,2	2,6	8,5	7,5	3,5
Unemployment	6,8	6,7	6,6	7,1	7,2	7,3	7,2	7,2	7,2	7,2	7,1	7,1	7,7	6,8	7,2	7,2

	Quarterly rate (QoQ, %)												Annual rate (YoY, %)			
Eurozone	2022				2023				2024				2021	2022	2023	2024
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Eurozone	**0,6**	**0,8**	**0,3**	**-0,3**	**-0,3**	**0,1**	**0,3**	**0,2**	**0,3**	**0,3**	**0,3**	**0,4**	**5,3**	**3,3**	**0,1**	**1,1**
Germany	0,8	0,1	0,4	-0,6	-0,5	0,1	0,2	0,2	0,2	0,2	0,3	0,3	2,6	1,8	-0,5	0,9
France	-0,2	0,5	0,2	0,0	-0,4	0,1	0,4	0,2	0,2	0,3	0,2	0,3	6,8	2,6	0,2	1,0
Italy	0,2	1,1	0,5	-0,1	-0,6	-0,1	0,3	0,1	0,2	0,3	0,4	0,3	6,7	3,9	0,0	0,9
Spain	-0,2	1,5	0,2	-0,2	0,0	0,2	0,3	0,3	0,3	0,2	0,3	0,3	5,5	4,6	0,7	1,0
Netherlands	0,3	2,4	-0,2	-0,4	-0,2	0,2	0,3	0,3	0,3	0,4	0,4	0,4	4,9	4,2	0,4	1,3
Belgium	0,6	0,5	0,0	-0,4	-0,2	0,1	0,3	0,3	0,3	0,4	0,4	0,3	6,1	2,9	-0,1	1,2
Ireland	7,0	2,2	2,3	-1,1	-0,1	0,8	0,4	0,4	1,1	1,1	1,1	1,1	13,4	11,3	1,6	3,5
Portugal	2,4	0,1	0,4	-0,3	0,2	0,4	0,6	0,6	0,4	0,3	0,3	0,2	5,5	6,6	1,0	1,7
Greece	2,2	0,6	-0,5	-0,1	0,3	0,2	0,1	0,3	0,4	0,6	0,6	0,5	8,1	4,9	0,4	1,6
Finland	0,5	1,0	0,2	-0,4	-0,3	0,2	0,2	0,3	0,3	0,2	0,2	0,2	3,0	2,6	0,0	1,0
Luxembourg	0,7	-0,5	0,3	0,4	0,4	0,3	0,3	0,3	0,6	0,6	0,6	0,6	5,1	1,8	1,2	2,0
Austria	1,2	1,9	0,2	-0,4	-0,3	0,2	0,3	0,3	0,2	0,2	0,2	0,2	4,7	4,8	0,4	1,0
Slovenia	-0,1	0,2	-1,4	0,0	-0,1	0,2	0,2	0,2	0,4	0,4	0,4	0,4	8,3	4,8	-0,4	1,4
Malta	1,1	0,9	1,3	-0,3	-0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	11,6	6,4	0,9	1,3

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RECENT DEVELOPMENTS

DISSECTING THE MULTIPLE SHOCKS AND THEIR DIFFERENT TIME FRAMES

Getting a read on the economic situation is being complicated by the series of shocks: **past (temporary) shocks are dovetailing with a new (more persistent) shock**, making it hard to pin the blame on either.

Exiting this pandemic crisis is not business as usual. It is a sequence of two adjustments: first to durable goods (already well underway) and then to services (now deploying more extensively). They are the **result of the release of pent-up demand and the dislocation of production chains. And piling on to these adjustments is the new energy supply shock. This shock, powerful and more persistent**, is still scrambling the signal: what is the extent of the damage, what is the potential impact on inflation, what adjustments have already been made, and which ones are still called for?

The easing of constraints on production lines is now clearly visible since the summer of 2022. The number of companies reporting constraints on their activity is decreasing. In the manufacturing sector, fewer and fewer companies see materials and equipment limiting their activity (the first of the factors constraining production), while **in the services sector constraints linked to labor shortages are also perceived to be decreasing**.

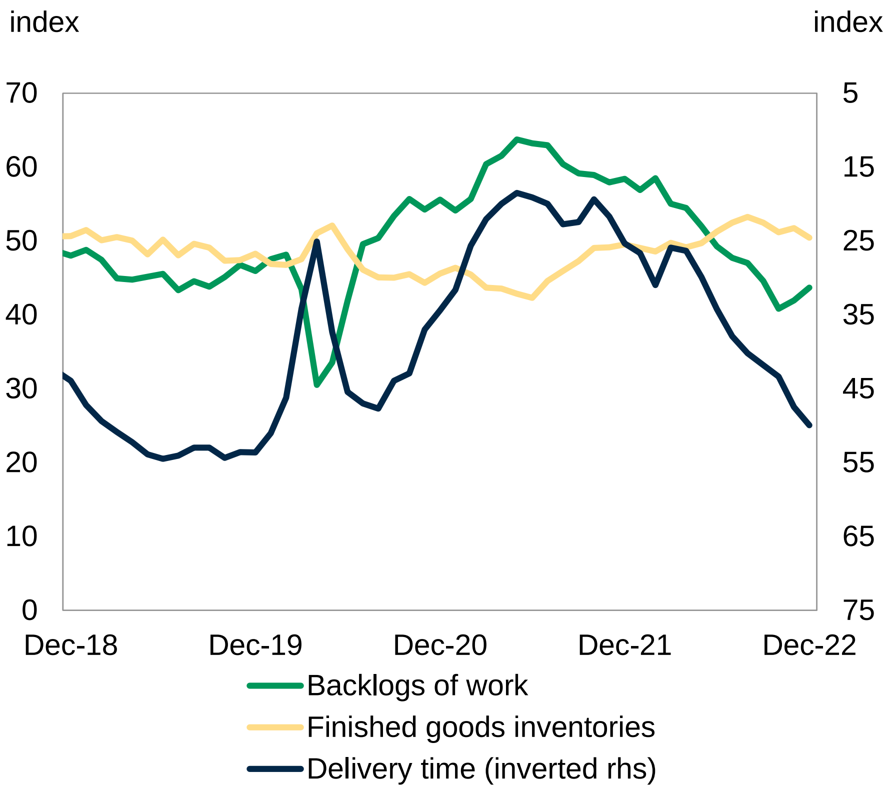
The new shock linked to the war is unfolding. Even if dependence on Russian hydrocarbons is falling sharply, this comes at a high cost. With the exception of hydrocarbons, the Eurozone has few critical strategic dependencies on Russia. While few sectors are affected by shortages and have had to cut production quantities, many are affected by rising input costs.

Competitiveness would already be affected by higher energy costs compared to other areas. The competitive position outside the European Union is therefore very weak and export prospects are declining, according to surveys in the manufacturing sector. Industrial production continues to grow, but at two speeds depending on energy consumption, with the most energy-intensive activities having already reduced their production for several months.

WEAKENING OF GLOBAL DEMAND

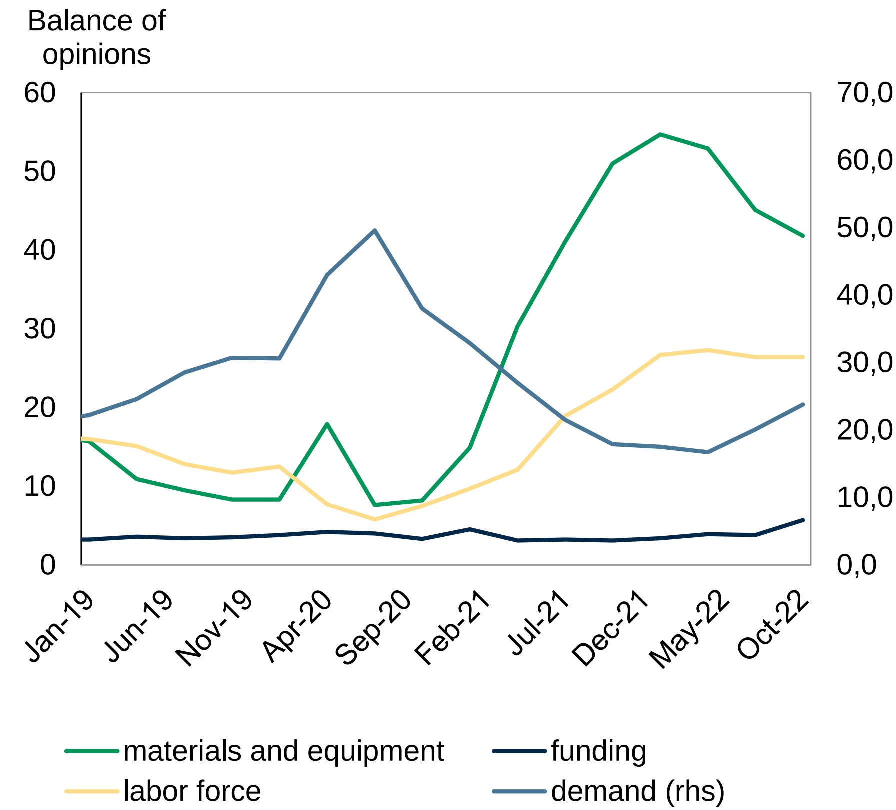
PROGRESSIVE RESORPTION OF POST-COVID SHOCK

Manufacturing : lower constraints on value chains



Sources: Markit PMI, Crédit Agricole SA / ECO

Manufacturing : factors constraining activity

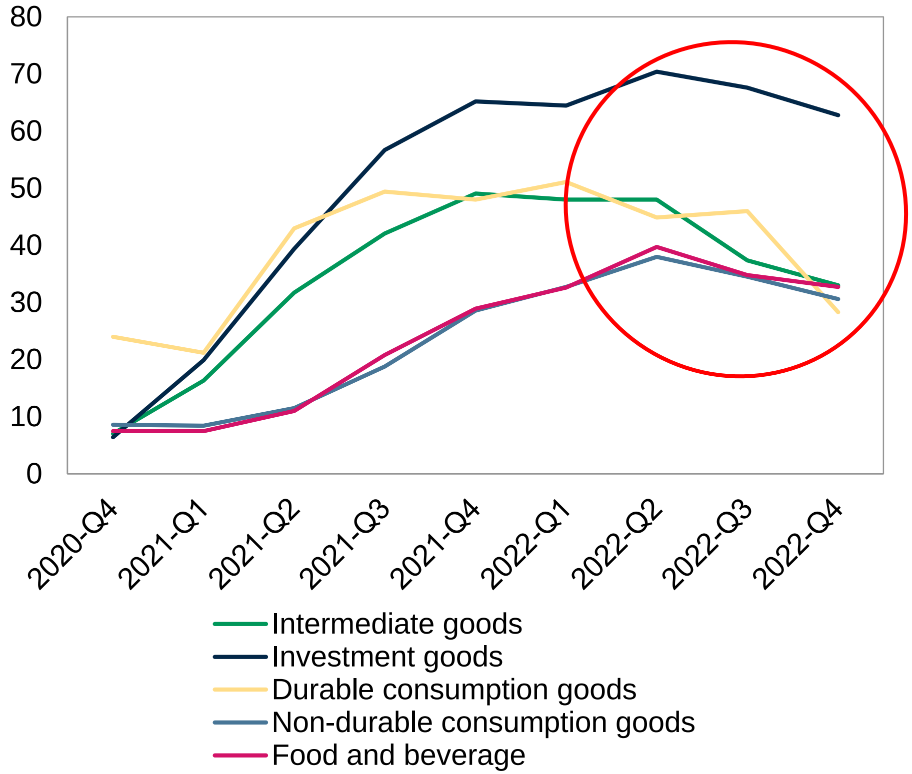


Sources: European Commission, Crédit Agricole SA / ECO

WEAKENING OF GLOBAL DEMAND

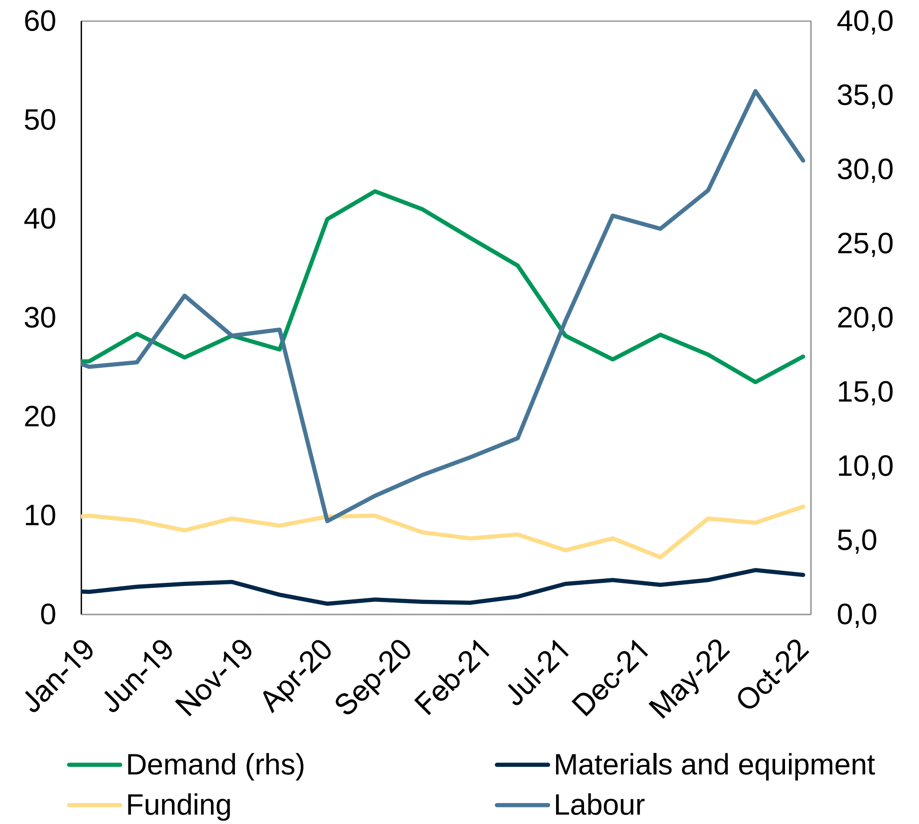
THE PEAK IN MATERIALS SHORTAGES IS BEHIND IN MANUFACTURING, SO IS THE PEAK IN LABOUR FORCE SHORTAGES IN SERVICES

Manufacturing : factors constraining activity-shortages in materials and equipment



Sources: ESI, European Commission, Crédit Agricole SA / ECO

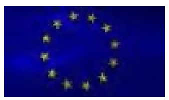
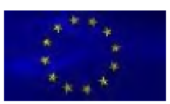
Services : factors constraining activity



Sources: ESI, European Commission, Crédit Agricole SA / ECO

THE NEW WAR SHOCK

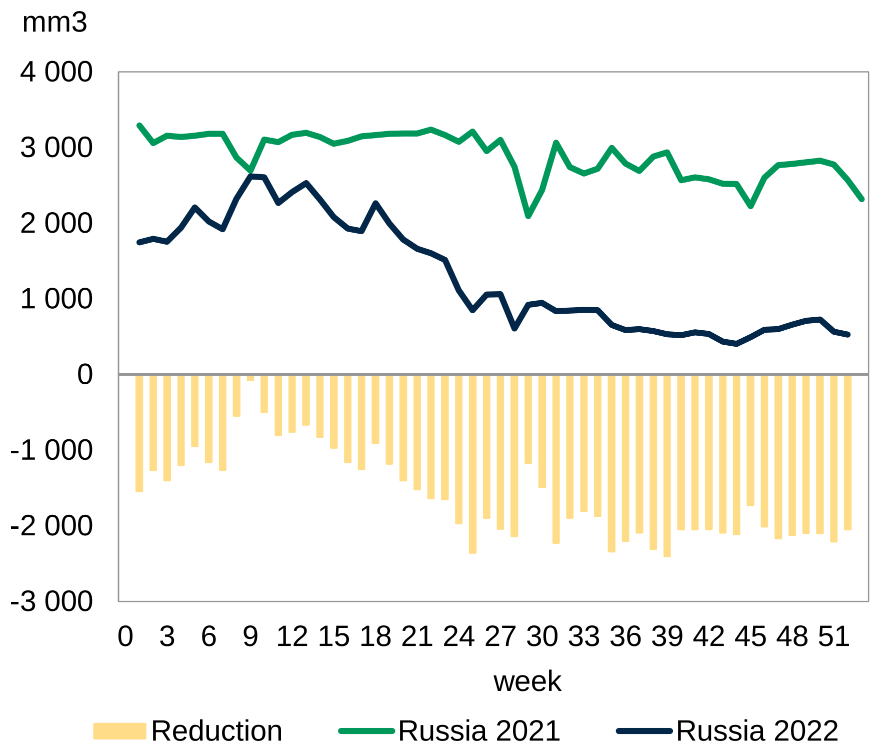
WITH THE EXCEPTION OF FOSSIL FUELS, FEW CRITICAL DEPENDENCIES FROM RUSSIA

Dependent country	Source of dependence	Number of dependent products	Diversification potential	%of total import value	Type of products
		820	69% / 31%	15,4%	• Active ingredients, antibiotics, vaccines, hormones, vitamins, medical devices • Plastics, gum, alloys, glass, paper, steel • Wind generators, electric motors and generators, turbines • Printers, electric magnets, base stations, computers
		10	13% / 88%	0,2%	• Fossil fuels, nickel, lithium, phosphates, ammonia

THE NEW WAR SHOCK

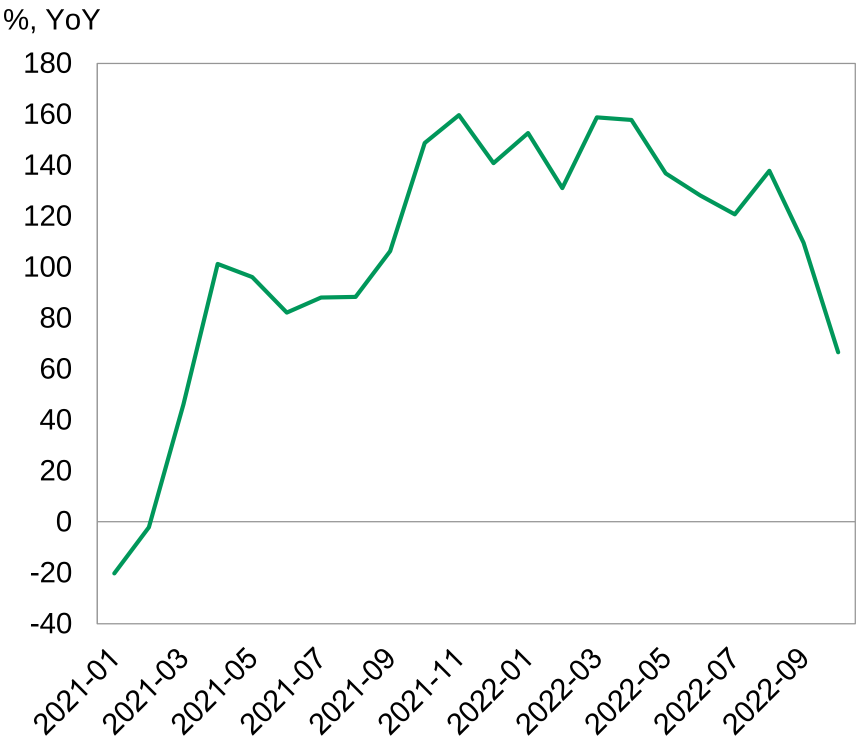
LOWER DEPENDENCE FROM RUSSIAN ENERGY BUT AT A HIGH COST

Notable fall in gas imports from Russia



Sources : McWilliams, B., G. Sgaravatti, G. Zachmann (2021), Crédit Agricole SA / ECO

Strong increase in energy import prices

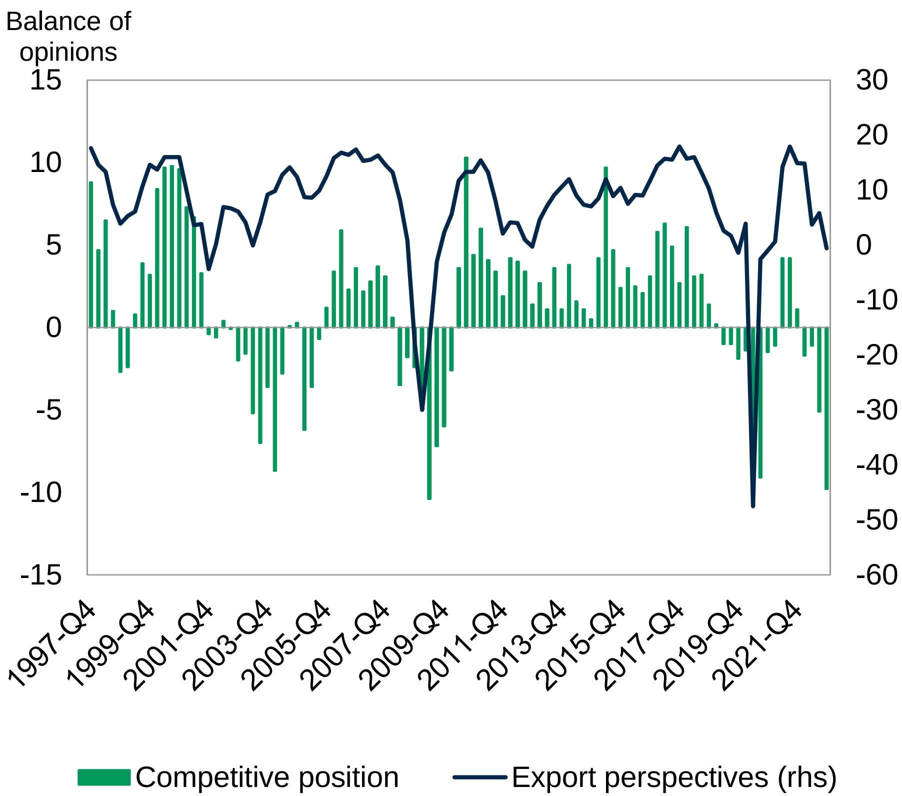


Sources: Eurostat, Crédit Agricole SA / ECO

THE NEW WAR SHOCK

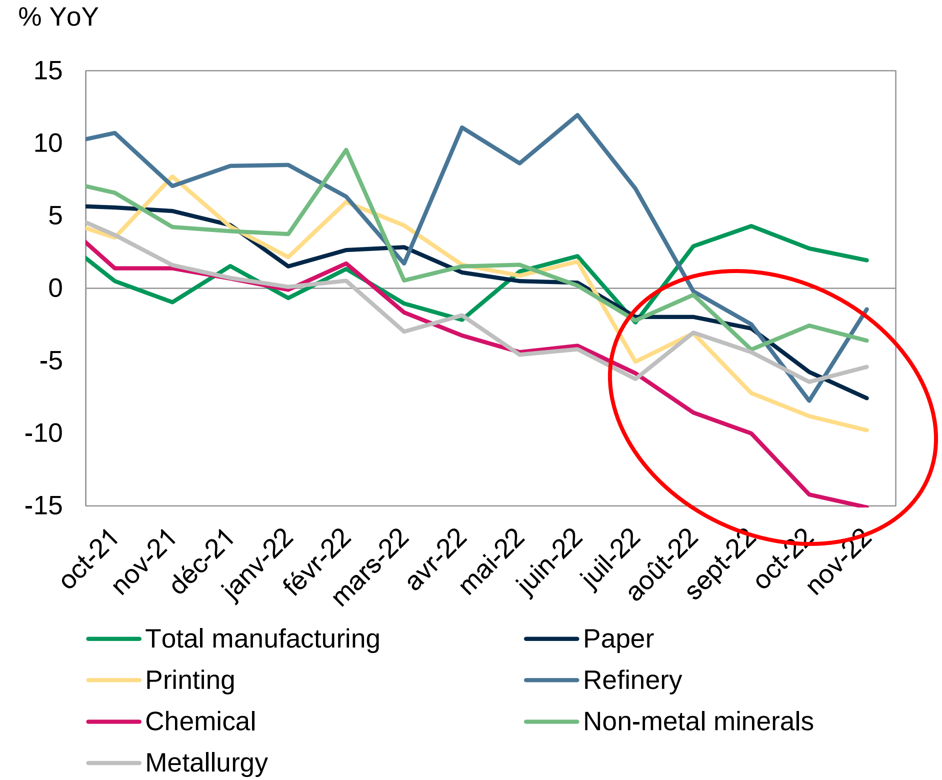
COMPETITIVENESS ALREADY AFFECTED

Competitive position outside the EU and export perspectivese n baisse



Sources: European Commission, Crédit Agricole SA / ECO

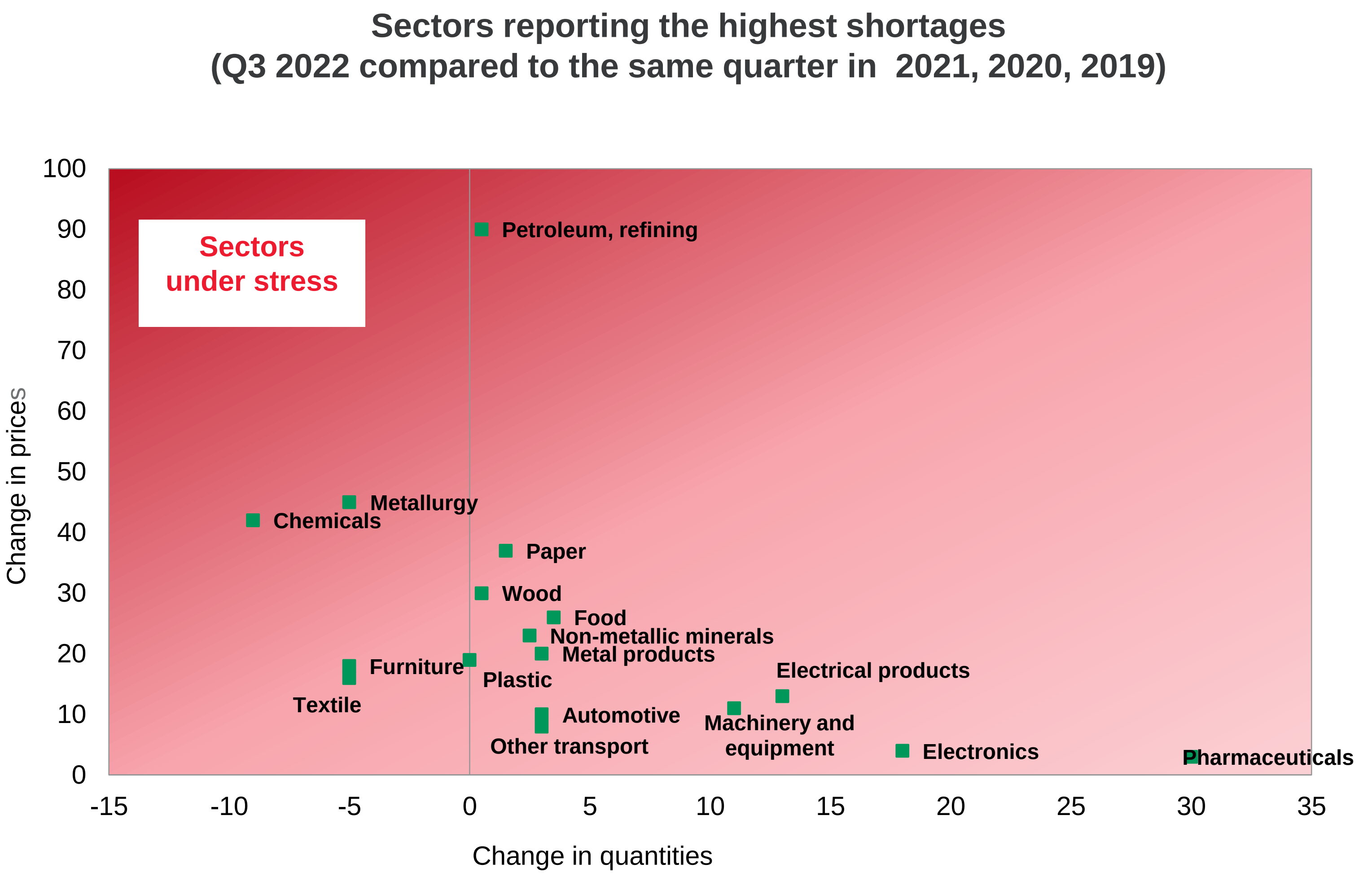
Two-speed industrial production according to energy intensity



Sources: Eurostat, Crédit Agricole SA / ECO

THE NEW WAR SHOCK

FEW SECTORS AFFECTED BY SHORTAGES, MOST SECTORS AFFECTED BY HIGHER COSTS



Sources: European Commission, Crédit Agricole SA/ECO

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THE NATURE OF INFLATION : SUPPLY OR DEMAND, THAT IS THE QUESTION

INFLATION: A TOO QUICKLY RESOLVED DEBATE

How inflation develops will depend on its true nature: mostly a supply shock, to a lesser extent a demand shock, but also a supply destruction shock – which can result from the inflation shock itself and the economic policies applied. And the debate over its nature is not yet settled: **for the ECB, current inflation is due to demand and supply in equal measures, while the European Commission blames supply shocks for 80% of production prices.**

Yet really, the mixed impact of both shocks is at work. The bump-up in core inflation (5.2%), which began in Q321, was caused mainly by supply-side constraints (bottlenecks in industrial goods supply and input shortages), then the volume of demand-side factors gradually increased over time as pandemic restrictions were lifted, specifically in services

Nonetheless, the role of energy in driving inflation remains preponderant: since 2019 the average increase in inflation in the energy-intensive components of the price index is 9.7%, while in the energy-saving components is 6.7%. **The energy-intensive components explain more than half of the increase in the services price index, just less than half of the increase in the goods index.** The presence of second-round effects, with a diffusion of the rise in energy prices to the other components *via* production costs, is now clearly visible. The peak in the transmission of the rise in energy prices to production prices was reached in June. Since then, the correlation between the two variables has weakened and the transmission of the fall in energy prices to producer prices has begun.

But relative price adjustments are now well underway, and **survey data point to the unwinding of supply chain tensions**: the sharp reduction in supplier delivery times is accompanied by the smallest rise in input prices in a year in industry and a weakening of the sales price rally.

The first declines in import prices for intermediate goods and non-food consumer goods are driving the moderation in global inflation, despite a strongly devalued exchange rate.

Excluding imported inflation, domestic price dynamics remain dominated by energy with high energy-consuming components explaining two-thirds of the price increase with a low import content (<18%).

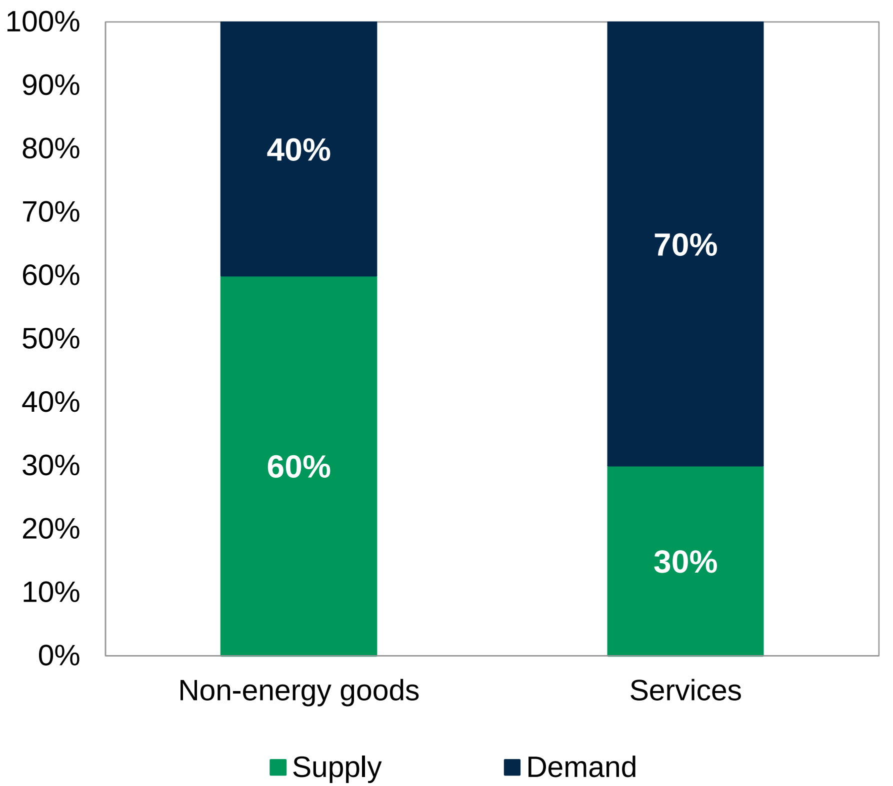
While core inflation remained high and rising in December, various alternative measures of core inflation are already showing a decline. We expect a sustainably high gas price over the medium term as global LNG supply will remain constrained through 2025. Despite a still-high gas price its contribution to inflation will be lower than in 2022.

It is on this effect and on a fall of global goods inflation, due to supply normalisation and weakened demand **that our scenario assumes a drop in inflation in 2023 and 2024 (to 7.5% and 3.5%, after 8.5% in 2022).**

THE NATURE OF INFLATION : SUPPLY OR DEMAND, THAT IS THE QUESTION

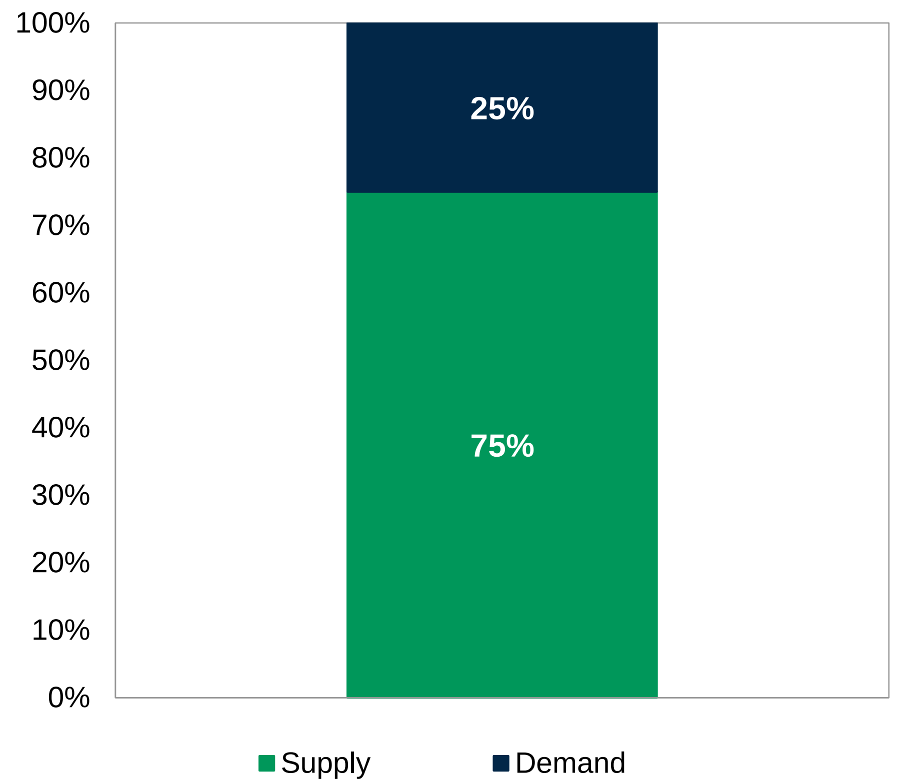
A DEBATE TOO QUICKLY DECIDED

ECB : decomposing inflationary shock into supply and demand (consumption prices)



Sources: ECB, Crédit Agricole SA / ECO

European Commission : decomposing inflationary shock into supplyand demand (production prices)

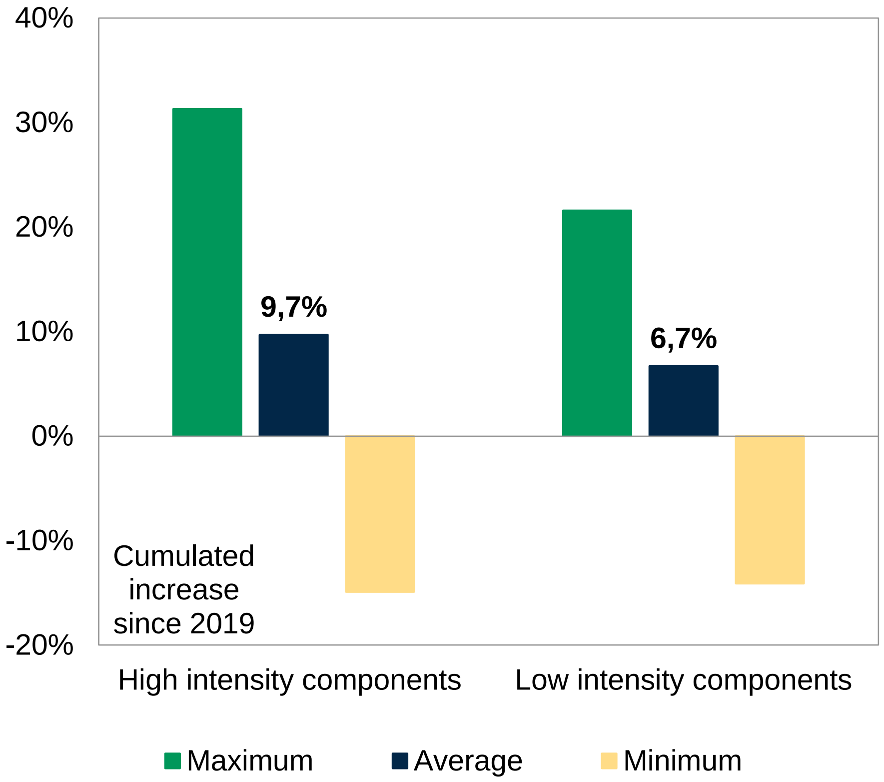


Sources: European Commission, Crédit Agricole SA / ECO

A SUPPLY SHOCK DOMINANCE

THE IMPACT OF ENERGY ON INFLATION

Distribution of price increase according to the energy intensity



Sources: ECB, Crédit Agricole SA / ECO

Energy-intensive components explain more than half the price increase

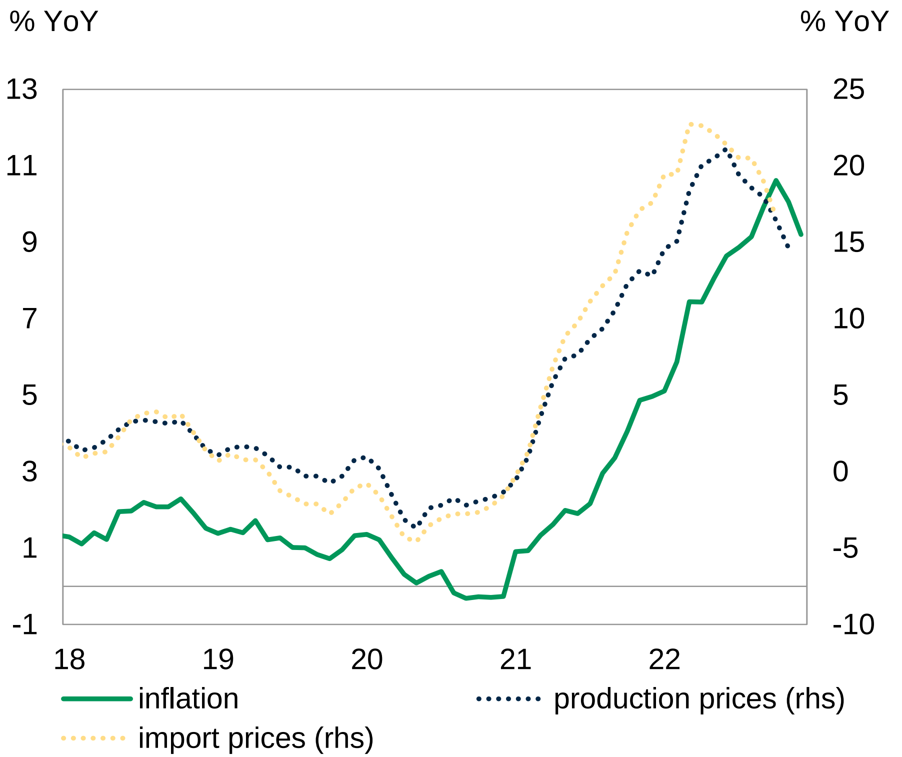
	Contribution	Inflation points
Services	52%	2,3%
Goods	47%	4,8%

Sources: Eurostat, Crédit Agricole SA / ECO

A SUPPLY SHOCK DOMINANCE

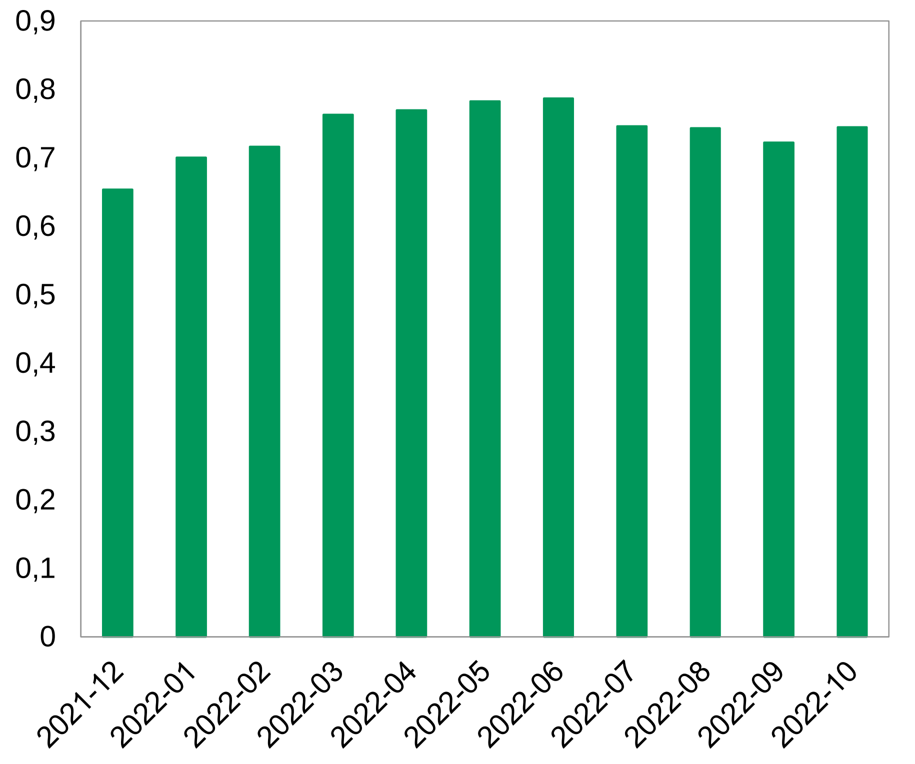
THE FADING IMPACT OF IMPORTED INFLATION

Fall in imported inflation fuelling the fall in producers' price inflation



Sources: Eurostat, Crédit Agricole SA / ECO

Correlation between imported energy prices and production price inflation



Sources: Eurostat, Crédit Agricole SA / ECO

A SUPPLY SHOCK DOMINANCE

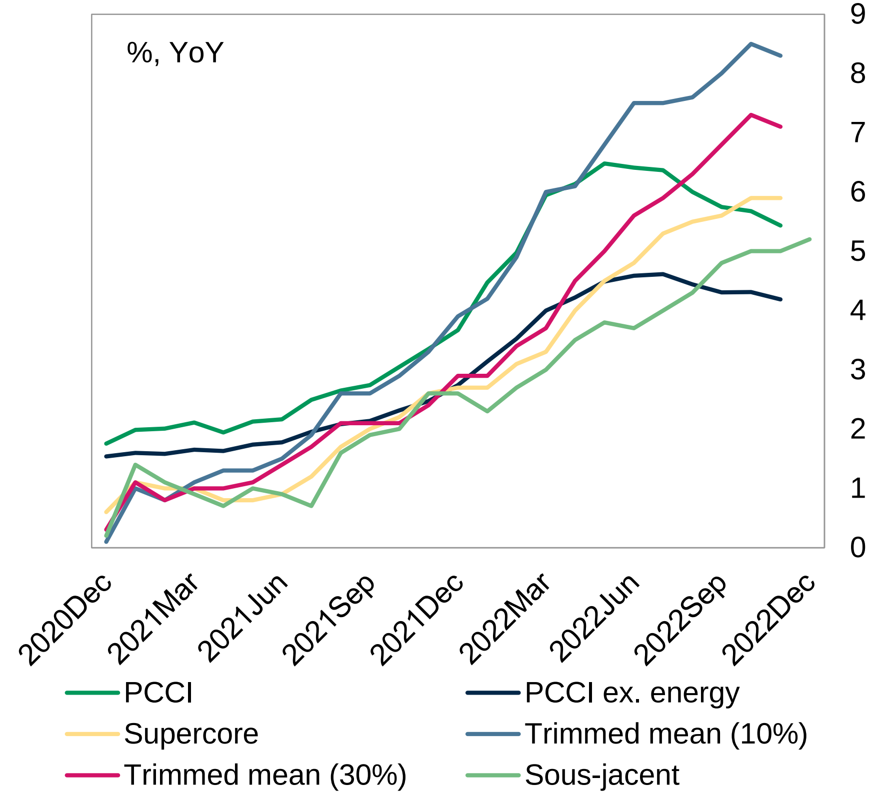
DOMESTIC INFLATION

Domestic inflation : excluding components with more than 18%import content

	Mid-2021	Q3 2022
Total domestic inflation	1,2%	4,5%
Energy intensive components	0,6%	3,0%
Non-energy intensive components	0,6%	1,5%

Sources: Eurostat, Crédit Agricole SA / ECO

Core inflation : different concept and developments



Sources: Eurostat, ECB, Crédit Agricole SA / ECO

THE NATURE OF INFLATION : SUPPLY OR DEMAND, THAT IS THE QUESTION

SECOND ROUND EFFECTS: HARDLY VISIBLE

The ECB fears a wage-price loop, the result of a materialization of an upward revision of inflation expectations. But market expectations are showing a certain inertia and do not anticipate a drop in inflation in the long term (BCE Survey of Professional Forecasters, SPF and Survey of Monetary Analysts, SMA).

The wait-and-see position of collective bargaining has taken into account the uncertainty about the nature of inflation and aims to leave margins of flexibility resorting more to bonuses than to salary increases. Thus in Q3 2022, although accelerating, the growth of the negotiated wage is attested to 2.9% over one year and projects an equivalent growth over the year 2023.

Admittedly, the more advanced indicators of wages negotiated by new entrants to the job market (*Indeed* survey on job vacancies, an indicator that remains unrepresentative, given the low turnover rate in the European labor market) point to a 5% increase in wages, but they also signal a plateau in Q3 2022 and a drop in job vacancies which should weigh on the dynamics of associated wages.

The recent slowdown in activity has already been communicated to the labor market. Employment rose again in Q3 (+0.3% q/q), but the loss of dynamism is evident at an annual rate (1.7%, after 2.6% in Q2). Hours worked, after having exceeded their pre-pandemic level, showed an initial decline (-0.1% q/q), under the effect of the slowdown in activity which should gradually spread to employment himself.

The moderation in the dynamics of the labor market is particularly evident in market services where employment growth weakened compared to the previous quarter (from 3.7% to 2% at an annual rate) and that of hours worked even more (from 7% to 3.4%).

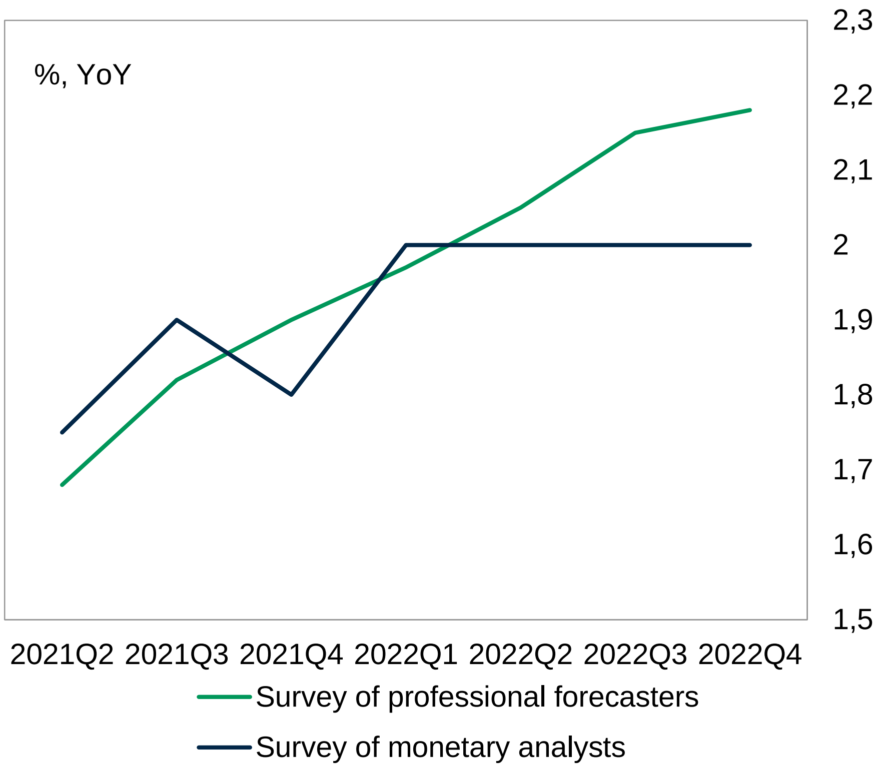
Effective wages per worker no longer benefit from the dynamics of the increase in working time and are also slowing down (from 4.9% in Q2 to 4%). The growth overhang of the unit wage nevertheless remains high at 4.2% for the year 2022. **Its acceleration will be limited by a lower wage drift than that experienced in 2021 and 2022.**

Labor hoarding, a fundamental element of the response to the COVID crisis, contributes to a solid labor market which, faced with the deterioration in activity, adds an additional element of confusion for the reading of the economic environment and especially prices. The rise in the unemployment rate to 7.2% in 2023 (after 6.8% in 2022) will be capped by the use of partial unemployment schemes in the industrial sectors most affected by the energy crisis.

SECOND ROUND EFFECTS: HARDLY VISIBLE

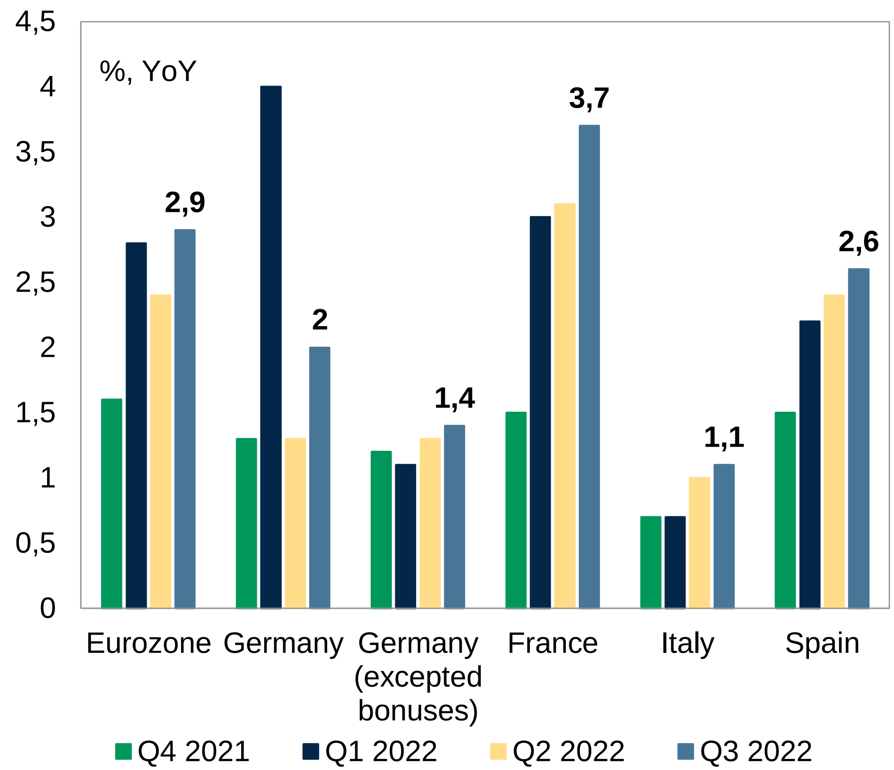
EXPECTATIONS ANCHORED AND SLOW WAGES

Long term inflation expectations still anchored to the ECB target



Sources: ECB, Crédit Agricole SA / ECO

Negotiated wages



Sources: Eurostat, BCE, Crédit Agricole SA / ECO

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THEMES OF THE SCENARIO

HOUSEHOLDS CONSUMPTION : AN UPSIDE RISK IN THE SHORT TERM, A DOWNSIDE RISK IN THE MEDIUM TERM

Our scenario includes a sharp slowdown in private consumption, with stagnation in 2023. After growth of 3.7% in 2021 and 4% in 2022, private consumption is expected to be flat in 2023 and 1.2% in 2024.

Losses in purchasing power (to the tune of -0.5% of real disposable income in H122) have yet to morph into a decline in consumption, which is likely to come at the end of the year.

The surplus savings left over from the crisis – around EUR1trn as of mid-2022 – has been a powerful engine for the consumer recovery, and once again made domestic demand more resilient in Q3. But those savings have been drained for lower-income households with a higher propensity to consume, and their savings rate has already tipped to negative.

High inflation could significantly increase the share of struggling households in the lowest income quintile. But the interest rate risk is more contained, because household debt is essentially attributable to high-income households, which would see a slight increase in their financial distress. The fact that most debt is granted to higher-income households therefore mitigates the systemic risk for banks, although significant differences exist between countries depending on the level of household debt, the share of low-income households in debt and the nature (fixed or variable rate) of the debt.

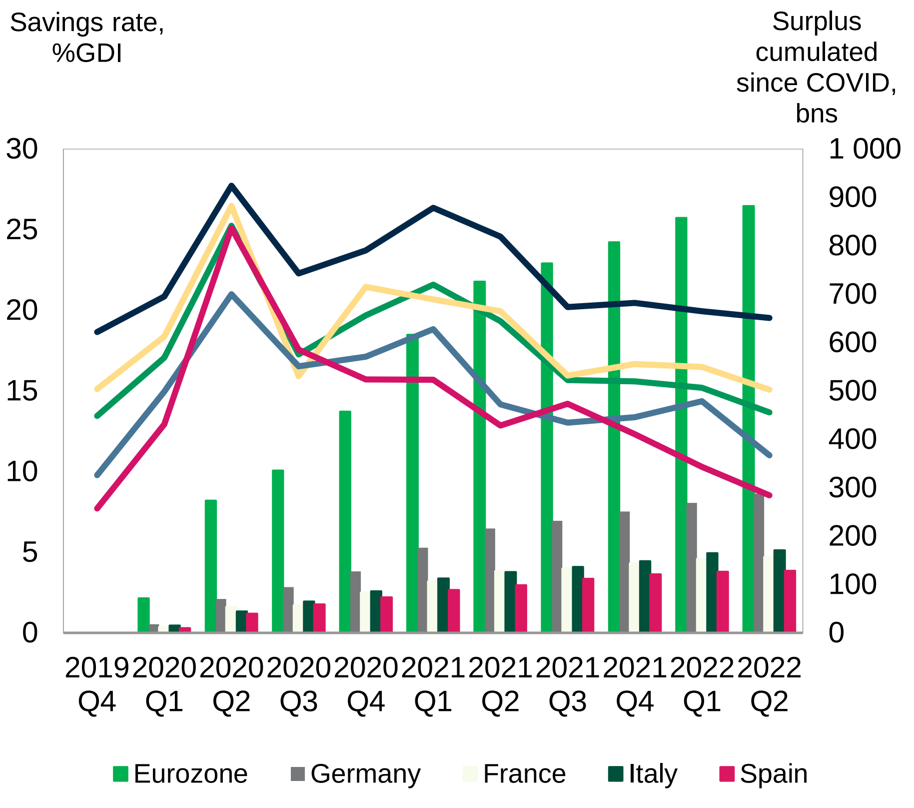
For the lowest-income households, a serious decline in their financial outlook means a growing number of people in financial distress will be dipping into their savings or going into debt. Inflation has also eroded the purchasing power of the net wealth accumulated since COVID. In Q222, net wealth in real terms made up “just” 8.7 times the real value of consumption (down from 9.4 times at end-2021). In the short term, the surplus savings may still act as a shock absorber to consumption, specifically of services and durable goods for more affluent households.

Public support was deployed with varying time frames according to country, but reached 1.3% of GDP in 2022, more than half of which went to consumers. Our scenario of a contained downgrade in household spending rests on this public backing. In the medium term, the stress of pursuing the financial goal of rebuilding real cash holdings back up will begin to ‘bite’; the reduction in inflation pressures in 2023 should, however, counteract the decline in purchasing power and allow private consumption to rebound.

HOUSEHOLDS CONSUMPTION

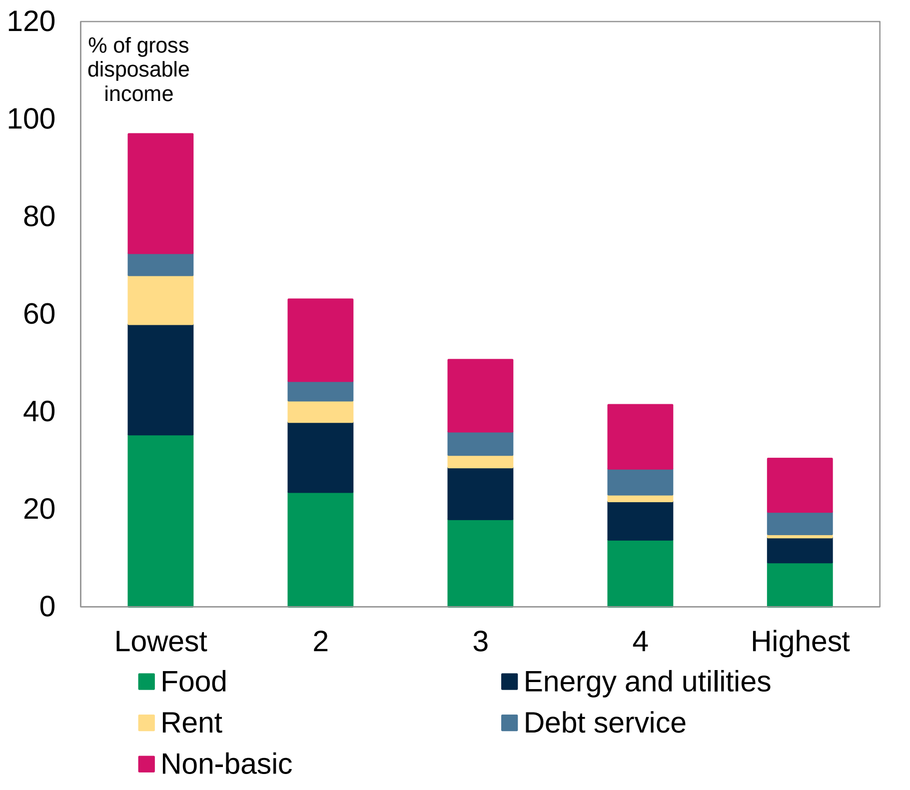
STILL LOTS OF SAVINGS BUT HIGHER SENSITIVITY OF THE POOREST TO INFLATION

A still-large surplus of savings



Sources: Eurostat, Crédit Agricole S.A./ECO

Average household expenditure shares by income quintile

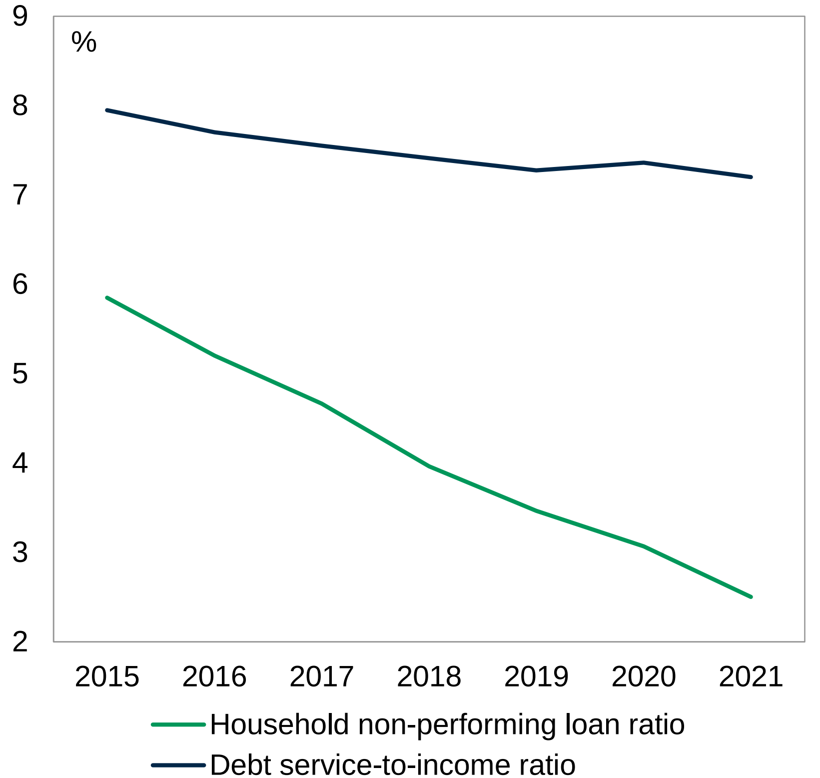


Sources: Eurostat, Crédit Agricole S.A./ECO

HOUSEHOLDS CONSUMPTION

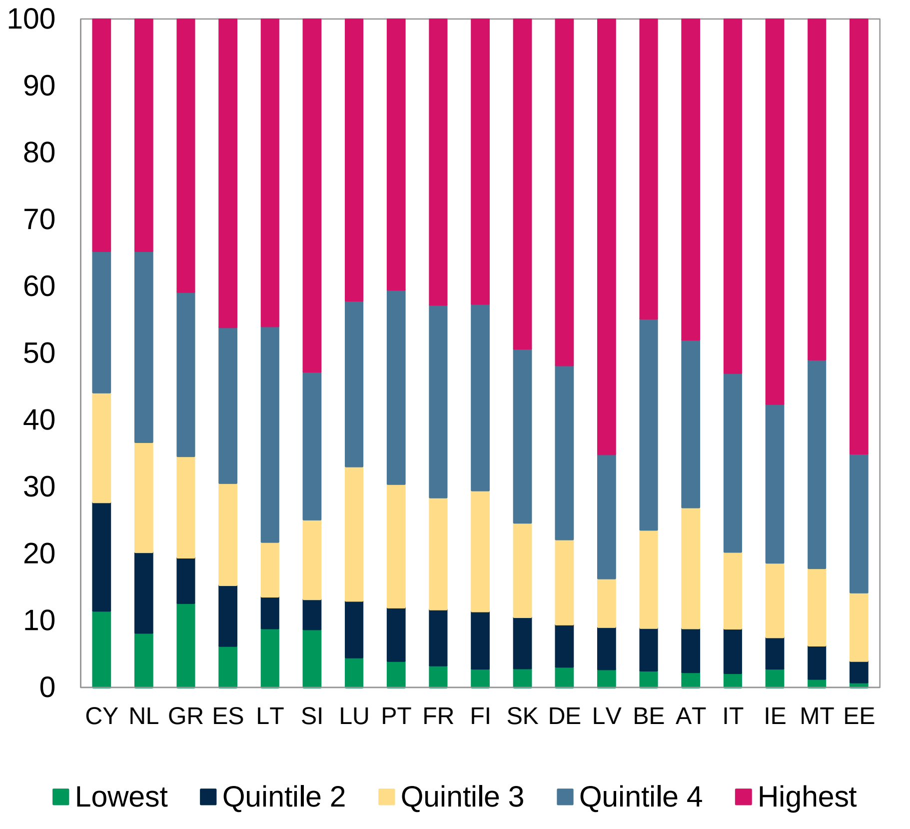
LESS SENSITIVITY TO RATES HIKES THAN TO INFLATION

Households: financial situation not too sensitive to rates hikes



Sources: Eurostat, ECB, Crédit Agricole SA / ECO

Households debt by quintile of the income distribution



Sources : ECB, Crédit Agricole SA / ECO

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POLICY MIX

TAKEN HOSTAGE

The focus of fiscal policy is now on containing the costs of rising energy prices for households and businesses. Public fiscal support has been deployed with a different timeframe depending on the country, but **has reached 1.3% of GDP in 2022**, more than half of which will go to households. Better targeting is requested by international institutions so as not to hamper the action of monetary policy, not to increase the risks of financial instability, but also not to blur the price signal at the risk of hindering the reduction energy consumption. But this targeting is complex to implement and politically costly in the face of a crisis affecting the middle classes. **We therefore expect the fiscal impulse to be barely negative in 2023 with a very marginal reduction in deficit and debt.**

Monetary and budgetary policy are thus overloaded by the absence of a regulatory policy that can cut the transmission belt of imbalances from the gas market to the electricity market.

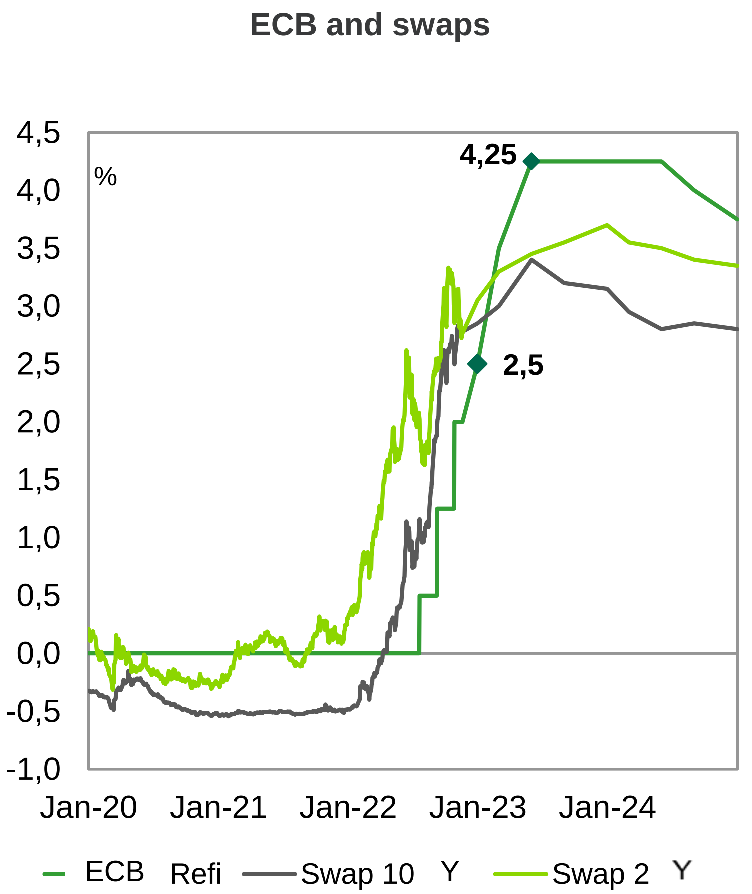
The effectiveness of monetary tightening is surrounded by legitimate uncertainty: what is its ability to reduce largely imported inflation? The ability of monetary restrictions and the consequent weakening of demand to moderate inflation depends on the true nature of inflation, driven by a supply shock or a demand shock. **The fear of a price-wage loop, the result of a materialization of an upward revision of inflation expectations, pushes the ECB to act more than the nature of inflation would require.** Despite the indices signaling that global inflation is moderating, the ECB has not chosen a wait-and-see posture. It increased the three key interest rates by 50 basis points each and raised the refinancing rate to 2.50% and the deposit rate to 2%. **After the aggressive ton at the December Governors' Council meeting we raised our forecast and expect now three 50bp hikes in January, February and March 2023 followed by a 25bp hike before the ECB stops hiking rates. That would bring the Refi rate to 4,25% and the deposit rate to 3.75%.**

But markets remain skeptical and the ECB's terminal rate rose little after its decision, going from 2.8% on December 14 to 3.25%, after its decision.

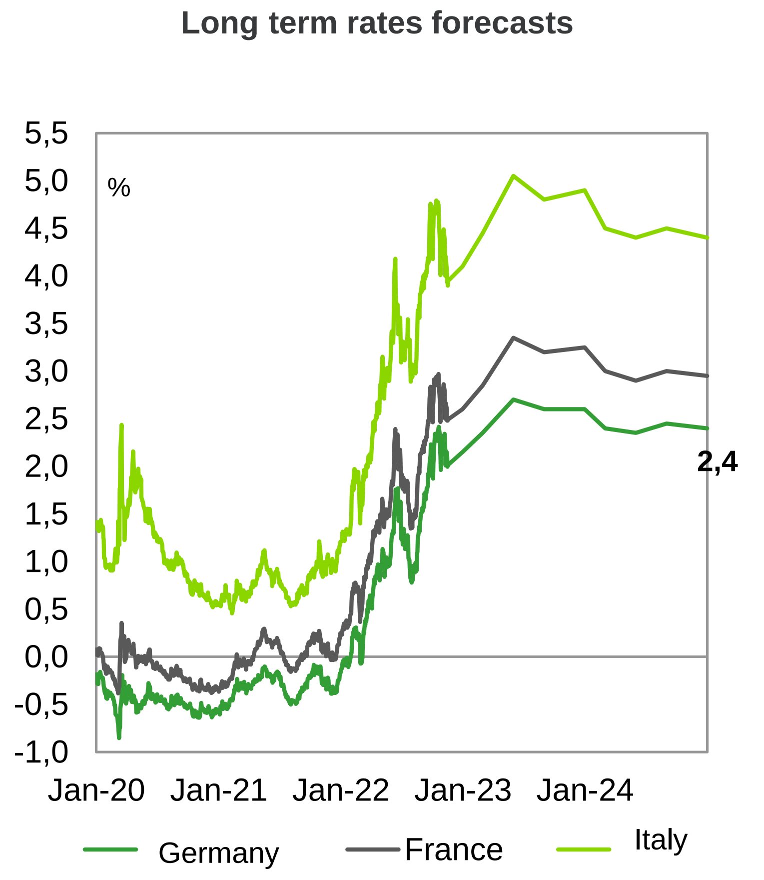
The risk of a monetary policy error is high on both sides. Arbitrating between the cost of doing too much and that of not doing enough is not easy. On the one hand, the less we do now, the more we are likely to have to do in the future. On the other hand, we must consider the political consequences of a more severe recession and the risks of financial instability..

INCREASING RATES FOR CREDIBILITY CONCERNS (4 MORE HIKES TO COME)

BUT MARKETS DONT NOT BELIEVE IT AND THE YIELD CURVE FLATTENS



Sources: Bloomberg, CACIB, Crédit Agricole SA/ECO



Sources: Bloomberg, CACIB, Crédit Agricole SA/ECO

ECB : AFTER THE RATES, THE BALANCE SHEET

OBJECTIVE : REGAIN ROOM FOR ACTION

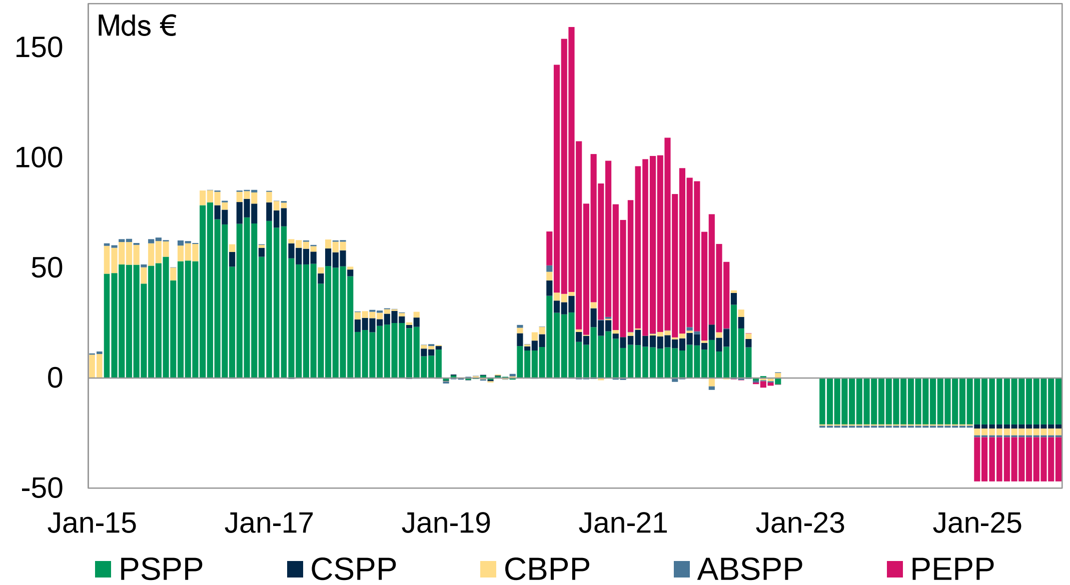
The ECB stopped its net purchases under the PEPP program in March 2022 and the traditional APP program in July 2022. Since then, it continues to withdraw maturing securities.

In March 2023 the ECB will start the QT on the APP program (€3,434bn) **by reducing its portfolio by €15bn per month. It will not sell any securities** but will reinvest €15bn less than the amounts of securities maturing.

We expect the pace of portfolio reduction to increase to €20bn per month in H2 2023 and to €25bn per month in 2024

The ECB has committed to fully reinvest the maturing amounts of the PEPP (€1,713bn) until 2024.

Quantitative Tightening **: reduction then net negative purchases**



Sources: BCE, CACIB, Crédit Agricole SA/ECO

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