EUROZONE
2023-2024 SCENARIO

THE BUMPY ROAD BACK TO NORMAL

July 2023

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WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

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SUMMARY

THE BUMPY ROAD BACK TO NORMAL

After overcoming the consequences of the pandemic in 2021 and taking the brunt of the energy crisis in 2022, it looks like 2023 might be the year we move past the effects of the energy crisis. After absorbing these extraordinary shocks, we will return to more usual dynamics, with Eurozone YoY growth brutally slowing down from 5.5% in Q122 to 1% in Q123. This dive does not foretell a recession, but instead a normalisation in behaviours following some major shocks that set off an abnormal amplitude of the cycle.

The slowdown is being aggravated by economic policies that are mutating from exceptional support into a more restrictive stance, with a shift in monetary policy that is preceding the one in fiscal policy.

The competitive shock of higher energy prices has been partly absorbed, and this will be good for terms of trade over the coming quarters. However, energy prices remain higher than before the shock and, with energy-intensive sectors operating below capacity, are leaving a permanent scar on the growth trajectory.

So the scenario is the result of opposing forces: the positive impact of tensions easing on global value chains and energy prices settling is providing a positive countershock and offsetting – if only partially – the drag of economic policies on activity.

For the time being, the pressure points that could tip the cycle are not all lined up. Job creation is still very dynamic and, most of all, the strength of the service sector continues to drive margins and inflation. As monetary restriction ramps up, however, inflation shock will subside, giving consumers back their rightful purchasing power.

And so we are projecting modest growth of 0.6% in 2023 and 1.3% in 2024, still beneath the Eurozone's potential.

Fiscal and monetary restriction join forces

Fiscal policy was relaxed in 2022 to support income in the face of inflation, but it has begun tightening again as those measures are withdrawn. Once again, the fiscal stimulus from national budgets will be negative (-0.8ppt in 2023 and -0.9ppt in 2024) as measures to ease the impact of the energy crisis are phased out. However, the general stance will be less negative, particularly in the southern Eurozone countries, due to expenditure financed by European funds. Fund disbursements will accelerate in 2023 and 2024, causing those economies to outperform their central Eurozone neighbours.

Mostly downside risks

Now that monetary policy has moved into its restrictive phase aimed at moderating demand, the tightening of credit conditions is one factor that may tip growth normalisation over to a more pronounced correction of the cycle. The other factor is the anticipated margin squeeze. The slowdown in activity and in the productivity cycle, as well as the inflation downturn limiting price "blurring", will interfere with the opportunistic profit-taking. While wage growth is lagging inflation, pressures to reduce the workforce and investment are on the rise. The scenario is moving into riskier territory, where all the trade-offs between monetary and fiscal objectives become more acute in the short term and pose major challenges to macroeconomic stability and the sustainability of growth.

SUMMARY

THE BUMPY ROAD BACK TO NORMAL

Forecasts

	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	**0,7**	**0,8**	**0,4**	**-0,1**	**-0,1**	**0,3**	**0,3**	**0,3**	**0,3**	**0,4**	**0,4**	**0,4**	**5,3**	**3,5**	**0,6**	**1,3**
Households consumption	0,3	0,9	1,3	-1,0	-0,3	0,2	0,3	0,3	0,3	0,3	0,4	0,4	3,7	4,5	0,1	1,2
Public consumption	0,2	-0,1	0,0	0,8	-1,6	0,2	0,2	0,2	0,2	0,2	0,2	0,2	4,3	1,4	-0,8	0,7
Total GFCF	-0,7	1,0	4,0	-3,6	0,6	0,8	0,2	0,3	0,4	0,3	0,4	0,4	4,0	3,8	0,8	1,4
G&S exports	1,7	1,8	1,2	-0,2	-0,1	0,6	0,7	0,7	0,7	0,8	0,7	0,7	10,6	7,4	1,7	2,8
G&S imports	0,1	1,8	4,1	-2,5	-1,3	0,6	0,8	0,7	0,7	0,7	0,7	0,7	8,3	8,4	0,3	2,8
Inventory changes (% of GDP)	0,6	0,6	0,8	0,8	0,4	0,4	0,5	0,5	0,5	0,5	0,5	0,5	0,5	0,7	0,4	0,5
Contributions to GDP growth																
Domestic demand excluding inve	0,1	0,6	1,5	-1,2	-0,3	0,3	0,2	0,3	0,3	0,3	0,3	0,3	3,8	3,4	0,1	1,1
Inventories	-0,2	0,1	0,2	0,0	-0,4	-0,1	0,1	0,0	0,0	0,0	0,0	0,0	0,1	0,2	-0,3	0,0
Net exports	0,9	0,1	-1,3	1,1	0,6	0,0	0,0	0,0	0,0	0,1	0,1	0,0	1,4	-0,2	0,8	0,2
Unemployment	6,8	6,7	6,7	6,7	6,6	6,8	6,9	6,8	6,9	6,8	6,8	6,7	7,7	6,7	6,8	6,8
Consumer prices	6,1	8,0	9,3	10,0	8,0	6,2	5,0	3,0	3,0	3,0	2,8	2,8	2,6	8,4	5,5	2,9
Unemployment	6,8	6,7	6,7	6,7	6,6	6,8	6,9	6,8	6,9	6,8	6,8	6,7	7,7	6,7	6,8	6,8
Current account (% of GDP)													3,3	2,6	3,5	0,8
Budget balance (% of GDP)													-5,4	-3,8	-3,4	-2,7
Fiscal impulse													0,6	-0,6	-0,9	-0,9

SUMMARY

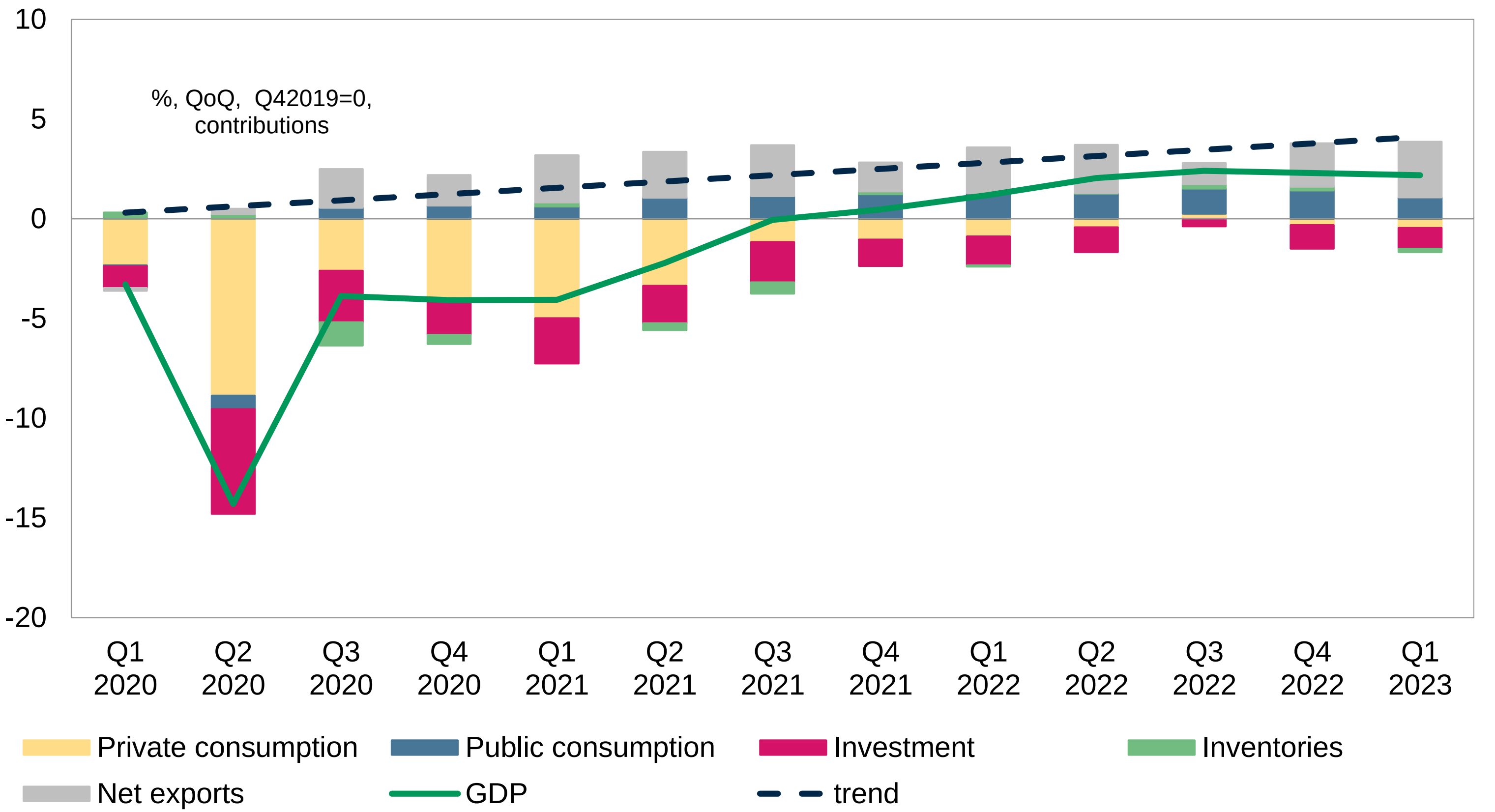
THE BUMPY ROAD BACK TO NORMAL

Forecasts	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	**0,7**	**0,8**	**0,4**	**-0,1**	**-0,1**	**0,3**	**0,3**	**0,3**	**0,3**	**0,4**	**0,4**	**0,4**	**5,3**	**3,5**	**0,6**	**1,3**
Germany	1,0	-0,1	0,5	-0,5	-0,3	0,1	0,2	0,3	0,3	0,3	0,3	0,3	2,6	1,9	-0,3	1,0
France	-0,1	0,5	0,2	0,0	0,2	0,1	0,1	0,2	0,3	0,4	0,3	0,4	6,4	2,5	0,6	1,0
Italy	0,1	1,0	0,4	-0,1	0,6	0,0	0,4	0,3	0,1	0,4	0,4	0,4	7,0	3,8	1,2	1,1
Spain	-0,4	2,5	0,4	0,4	0,5	0,3	0,2	0,3	0,5	0,6	0,4	0,3	5,5	5,5	2,0	1,6
Netherlands	0,5	2,6	-0,2	0,4	-0,7	0,2	0,2	0,2	0,3	0,4	0,4	0,4	4,9	4,5	0,5	1,2
Belgium	0,6	0,5	0,3	0,1	0,5	0,3	0,4	0,5	0,4	0,4	0,4	0,3	6,3	3,2	1,3	1,5
Ireland	7,9	2,1	2,5	-0,1	-4,6	4,3	0,7	0,7	0,5	1,2	1,2	1,2	13,4	12,1	0,6	4,3
Portugal	2,3	0,2	0,3	0,3	1,6	0,7	0,3	0,2	0,4	0,3	0,3	0,2	5,5	6,7	2,9	1,4
Greece	2,6	0,9	0,2	1,1	-0,1	0,3	0,2	0,4	0,5	0,7	0,7	0,7	8,1	6,0	1,5	2,1
Finland	0,5	0,6	-0,4	-0,6	0,2	0,2	0,2	0,3	0,3	0,3	0,3	0,3	3,0	2,1	0,0	1,1
Luxembourg	0,2	-0,1	1,5	-3,7	2,0	0,3	0,3	0,3	0,6	0,6	0,6	0,6	5,1	1,6	0,4	2,0
Austria	1,3	1,7	0,0	-0,1	0,1	0,1	0,1	0,2	0,3	0,4	0,5	0,5	4,7	4,9	0,7	1,2
Slovenia	1,2	0,7	-1,3	0,7	0,6	0,3	0,3	0,3	0,5	0,5	0,5	0,5	8,3	5,7	1,1	1,8
Malta	1,4	1,1	1,4	1,1	-0,5	0,4	0,4	0,4	0,4	0,4	0,4	0,4	11,6	7,1	1,9	1,5

OVERCOMING THE CONSEQUENCES OF CRISIS AND OF THEIR EFFECTS

PANDEMICS, GLOBAL VALUE CHAINS DISRUPTIONS AND ENERGY CRISIS

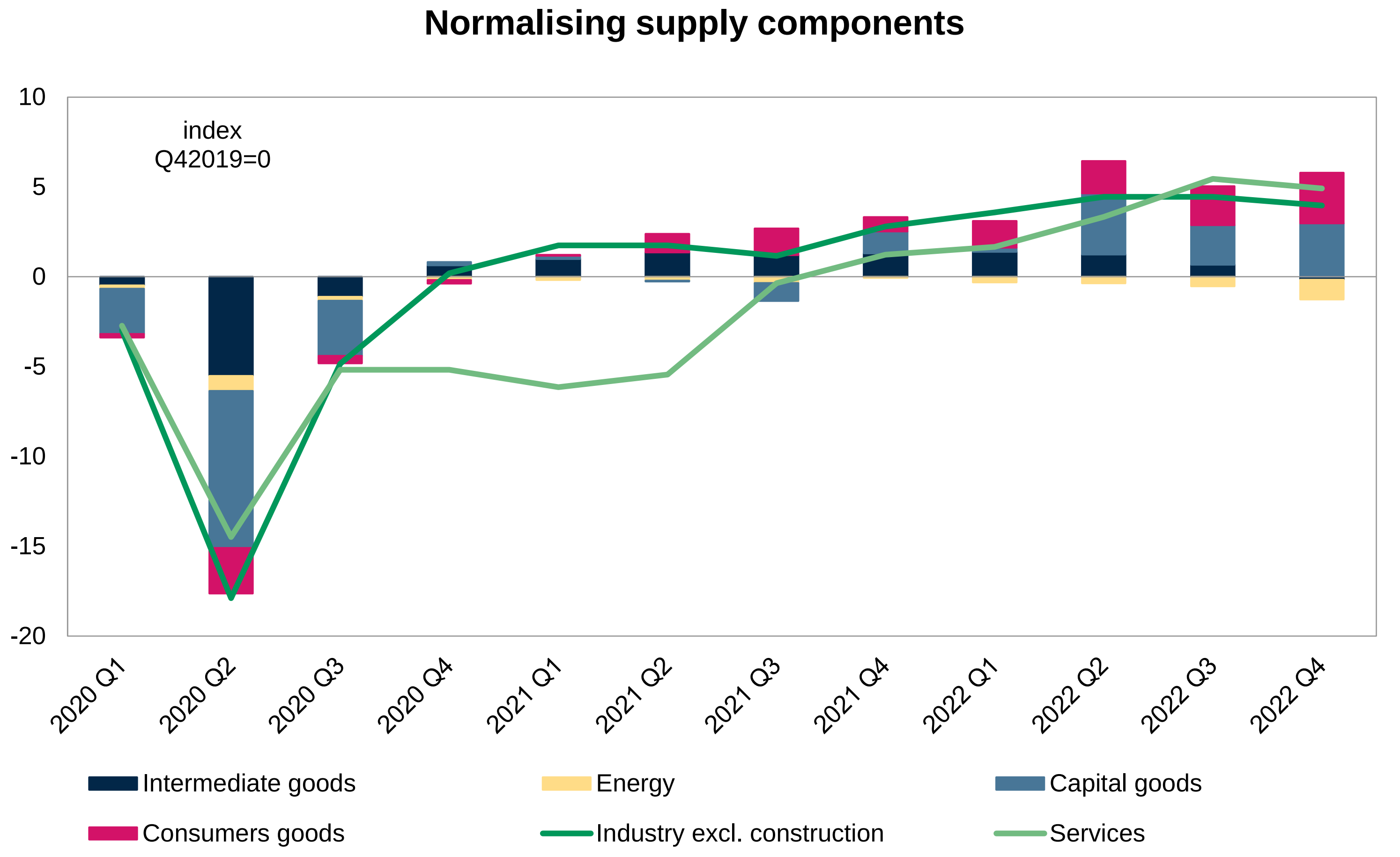
Normalizing demand components



Sources: Eurostat, Crédit Agricole SA/ECO

OVERCOMING THE CONSEQUENCES OF CRISIS AND OF THEIR EFFECTS

ABSORBING EXTRAORDINARY SHOCKS



Sources: Eurostat, Crédit Agricole SA/ECO

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RECENT DEVELOPMENTS AND SHORT-TERM SCENARIO

A NATURAL – BUT PRONOUNCED – SLOWDOWN IN ACTIVITY

With real GDP currently 2.2% above its pre-pandemic level, the slowdown in activity is natural. However, it is pronounced: growth YoY sagged from 1.8% in Q422 to 1.0% in Q123. In Q123, Eurozone GDP growth declined for the second consecutive quarter (-0.1% QoQ), dragged down by German growth (-0.3%) which also fell two quarters in a row. With the exception of Germany, Ireland, the Netherlands and Greece, all of the Eurozone's major countries reported growth.

Whereas domestic demand made another negative contribution to growth (-0.3ppt), the latter has moderated compared to the previous quarter (-1.2ppt). Consumer spending declined for a second consecutive quarter (-0.3%), though by less than the previous quarter, with inflation down compared to its Q422 peak. After providing a strong impulse at year-end, public spending dipped sharply (-1.6%) in response to the withdrawal of income-support measures. Investment rebounded (+0.6% after -3.5%), but growth remains modest. The downward adjustment in inventories took 0.4ppt away from growth. Once again, foreign trade's positive contribution to growth is due to a more pronounced downturn in imports than exports. While exports are not gaining momentum, the import slump is moderating.

The expansion phase is coming to an end, according to several indicators, specifically in the manufacturing sector. Normalisation of consumption and investment behaviours has been followed by their blockage caused by increased production costs and prices that drove orders down. After tensions on the value chains were resolved, precautionary stocks naturally declined, and the inventory cycle is now adapting to weaker demand.

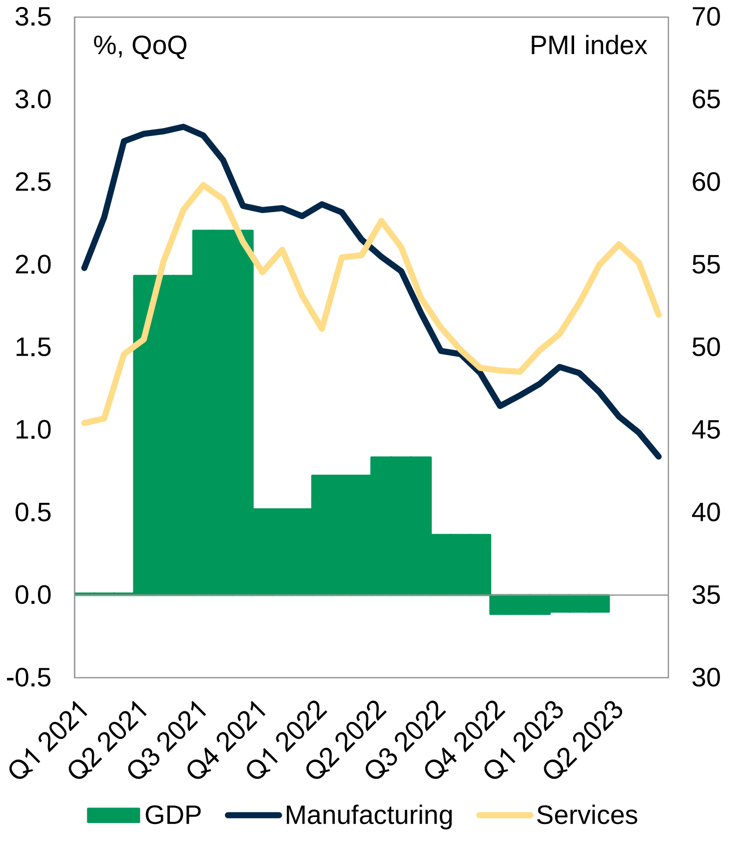
Despite a distinct slowdown in activity signalled by the June surveys, average Q2 growth is still slightly outpacing Q1 growth. There are two opposing forces behind this trend: one, the steepening downturn in manufacturing, and two, the robust (although moderating) growth in services. However, industrial activity will benefit from an easing of tensions on input prices. Conversely, demand for services continues to drive production as well as higher prices in the sector.

Weaker manufacturing activity has not yet triggered a rise in corporate failures. In the manufacturing sector, the corporate failure rate remains lower than before the pandemic. For the Eurozone economy as a whole, this rate remains relatively low and with the rebound underway for the past year it is scarcely higher than before Covid. Their increase remains limited to specific sectors (in hospitality, transport and logistics, the number of defaults is higher than pre-pandemic).

AFTER EXTRAORDINARY GROWTH AMPLITUDE…

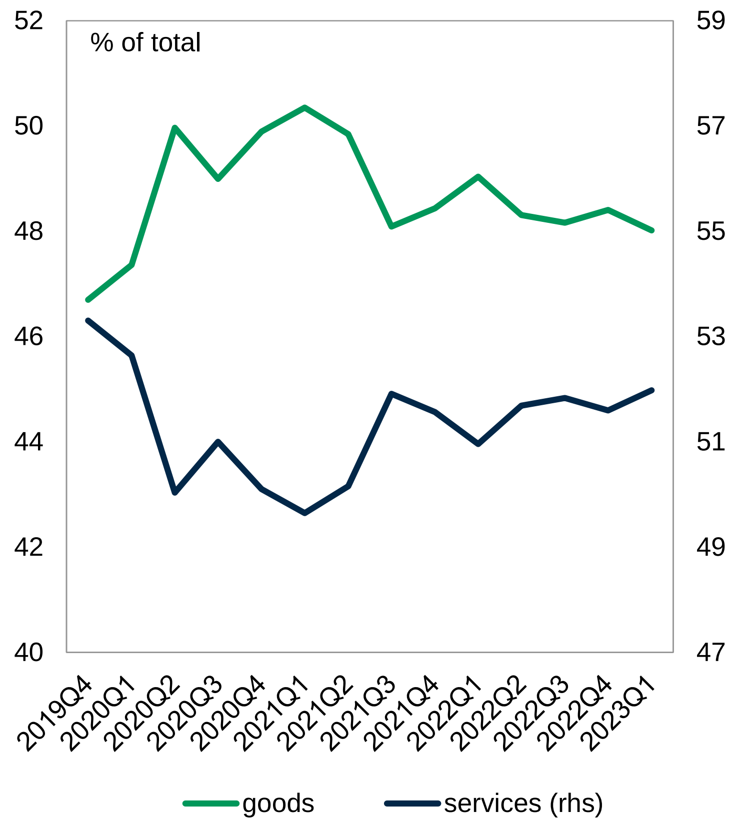
… BACK TO MORE USUAL DYNAMICS, NOT TO RECESSION

Weakening but not tipping the cycle



Sources: Eurostat, Markit, Crédit Agricole SA/ECO

Normalization of households consumption



Sources: Eurostat, Crédit Agricole SA/ECO

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THEMES OF THE SCENARIO

THE COUNTERSHOCKS ARE LIMITING THE SLOWDOWN IN ACTIVITY

Starting in Q2, our scenario shows moderate positive quarterly sequential growth.

Such growth is conditional on a gradual but moderate recovery in consumption benefiting from the decline in inflation, from improvement in real income and from the demand for travel and leisure services remaining high through the end of summer. This expenditure component may still be fuelled by surplus savings held by the wealthiest households, although a large portion of this has already been converted to illiquid real estate and financial assets.

Growth in investment ex housing is expected to persist, with the decline in the cost of intermediate goods and strong support from European funds. High profitability and solid corporate finances are also hampering the transmission of monetary tightening to investment. The real estate cycle is in a normalising phase and will have to adjust to an interest rate that has abruptly come out of the zone of deflationary risk and pandemic urgency and into restrictive territory. While monetary transmission has been quick, it is not over yet, which increases the downside risk weighing down this investment component.

The resilient labour market

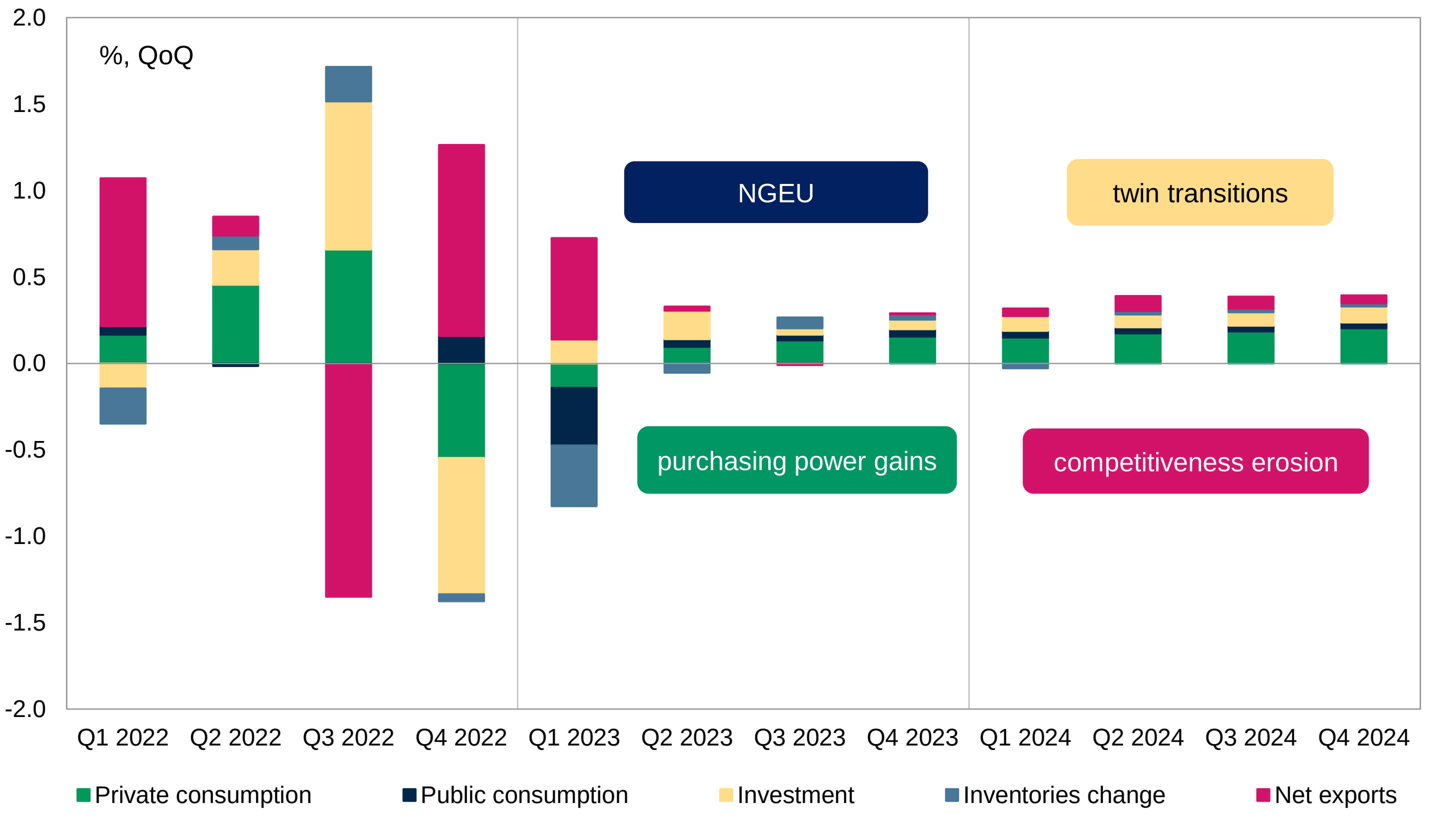
Though activity did hit a slump, job creation picked up speed in Q123 (+0.6% after +0.3%), and the number of hours worked continued to rise (+0.6%). Productivity growth was weaker as a result. Employment held on to its momentum in Q2, though job creation was at a one-year low. This moderation is also visible in the lower job vacancy rate (3.1% in Q123), which has not increased in three quarters.

Slowing productivity and a slight projected rise in unemployment are limiting the potential for wage hikes in most sectors except services. Any potential should be limited by the downward adjustment of inflation expectations, lesser need for real wage catch-up, and anticipated reduction in margins (ECB business survey). We are counting on per capita wages to pick up 5.1% in 2023 before slowing to 4% in 2024, with a lower contribution from minimum wage hikes, hours worked and bonuses.

A NORMALISATION IN BEHAVIOURS FOLLOWING SOME MAJOR SHOCKS

POSITIVE COUNTER-SHOCKS FACE ECONOMIC POLICIES MUTATING FROM EXCEPTIONAL SUPPORT INTO A MORE RESTRICTIVE STANCE

Contributions to growth and head/tailwinds

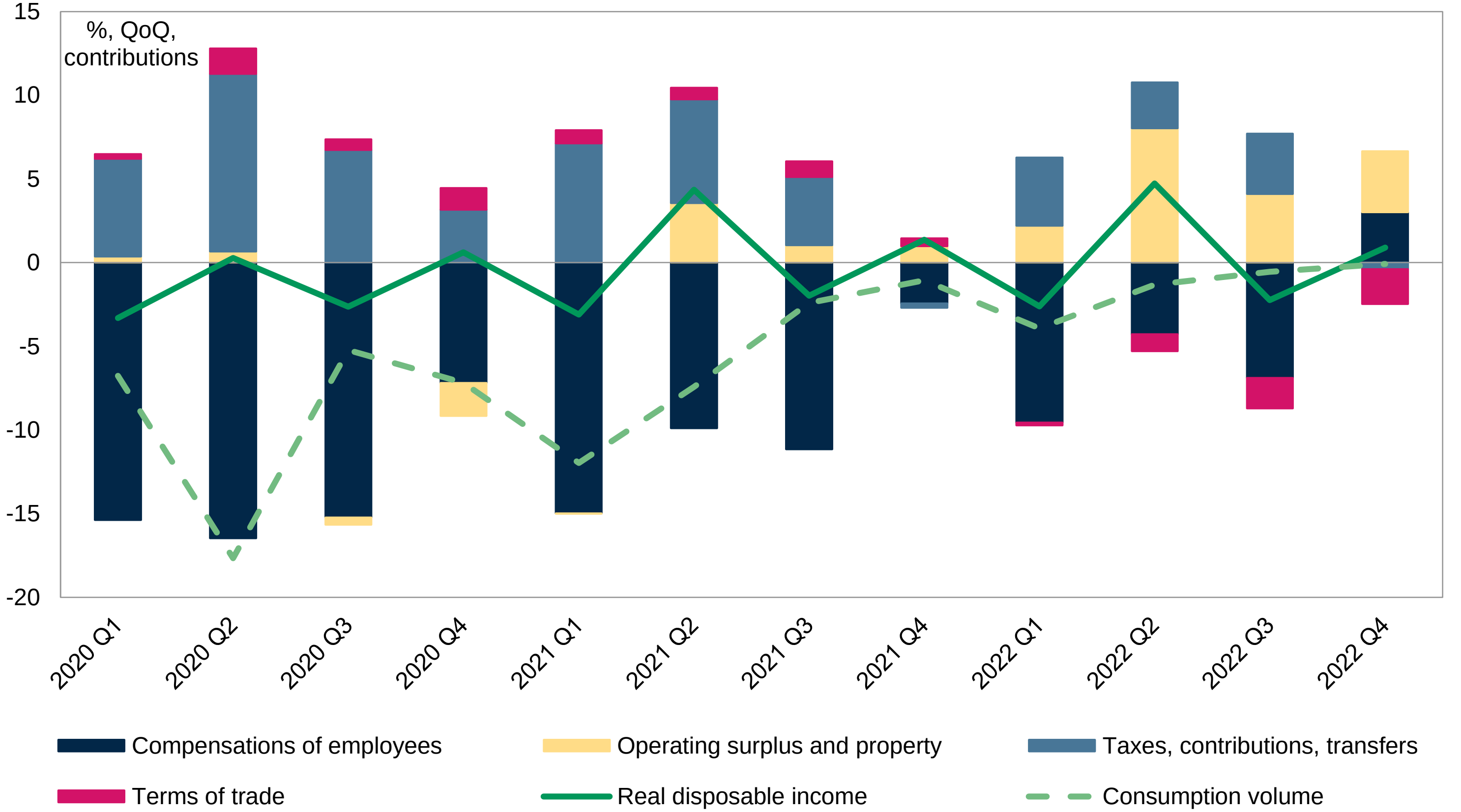


Sources: Eurostat, Crédit Agricole SA/ECO

HOUSEHOLDS’ REVENUES MORE RESILIENTS THAN CONSUMPTION

THE FALL IN IMPORTED INFLATION ALLOWS FOR RECOVERY IN PURCHASING POWER

Real growth in households disposable income and consumption



Sources: Eurostat, Crédit Agricole SA/ECO

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INFLATION AND ITS NEW DRIVERS

LESS IMPORTED INFLATION, MORE DOMESTIC INFLATION

Inflation fell once again in the Eurozone in June, to 5.5% year-on-year after 6.1% in May. Inflation is almost half as low now as its October 2022 peak. The contribution of energy to price growth was even more negative, with energy prices down 5.6% after a 1.8% decline in May. The increase in non-energy industrial goods prices is also slowing, up 5.5% in June after 5.8% in May. Though it remains high at 11.7%, food inflation also fell (12.5% in May). Services alone continue to drive core inflation higher, with prices increasing 5.4% after 5% in May.

Inflation decreased in all the major Eurozone economies, down 5.3% in France, 6.7% in Italy, 1.6% in Spain and Belgium, and 6.4% in the Netherlands. Only Germany posted an increase in inflation, at 6.8%, driven by rising services prices. This can be explained by the base effect of the decrease in transport prices in June 2022 following the introduction of the €9 ticket. This factor may have influenced the rise in services inflation in the eurozone.

Market inflation expectations remain firmly in line with the ECB's medium-term target. The overall consensus in Eurozone forecasts is that inflation will decrease rapidly with no major detriment to growth, though past experience of similar situations is slight (rate hikes having generally negatively impacted economic activity and the labour market).

The ECB has still not failed in its quest to control inflation and it may not necessarily lead to arbitrage in favour of a high cost to economic activity generated by a more restrictive monetary policy. This is because the perceptions of economic agents are informed more by headline inflation and its high-frequency consumption components including energy and food, the prices of which are clearly slowing, than by core inflation, excluding volatile components, which is more difficult to understand other than through the consumption of services, the prices of which continue to rise.

But for the ECB, inflation is still too high and will remain so for too long. The ECB is concerned about the trend in unit labour costs, which are being driven upwards by per capita wage growth and lower productivity. Despite the weakening of economic activity, the ECB is surprised by the resilience of employment. The central bank is concerned that the tight labour market conditions will push both wages and profits to seek full compensation for price increases, triggering an inflationary spiral and moving inflation expectations away from its target.

This is what prompted it to raise the three key interest rates by 25 basis points in June, bringing the marginal deposit facility rate to 3.5% and the main refinancing rate to 4%. ECB President Christine Lagarde said that unless there is a change in core inflation she will continue to raise rates at the next meeting in July.

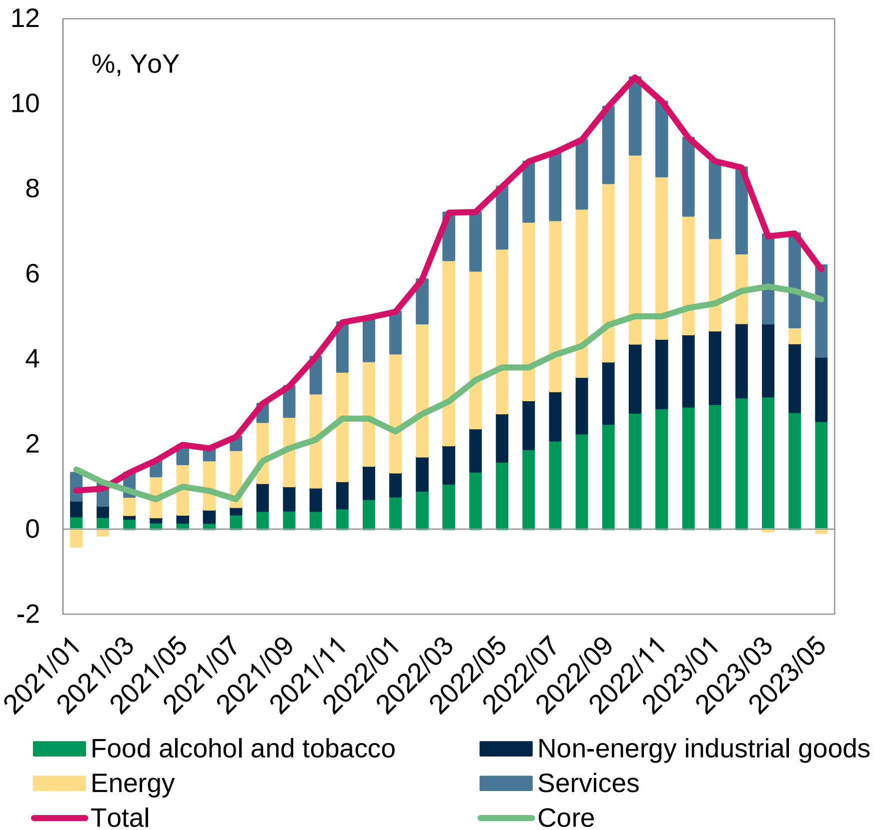
Our scenario shows inflation still above 5% at the end of the summer and above 3.5% at the end of the year. After reaching an annual average of 5.5% in 2023, the inflation rate will decrease to 2.7% in 2024.

We expect a 25bp increase in July and a second 25bp increase in September, followed by a break. The ECB is expected to start gradually cutting rates in Q4 2024.

CORE INFLATION PERSISTENCE

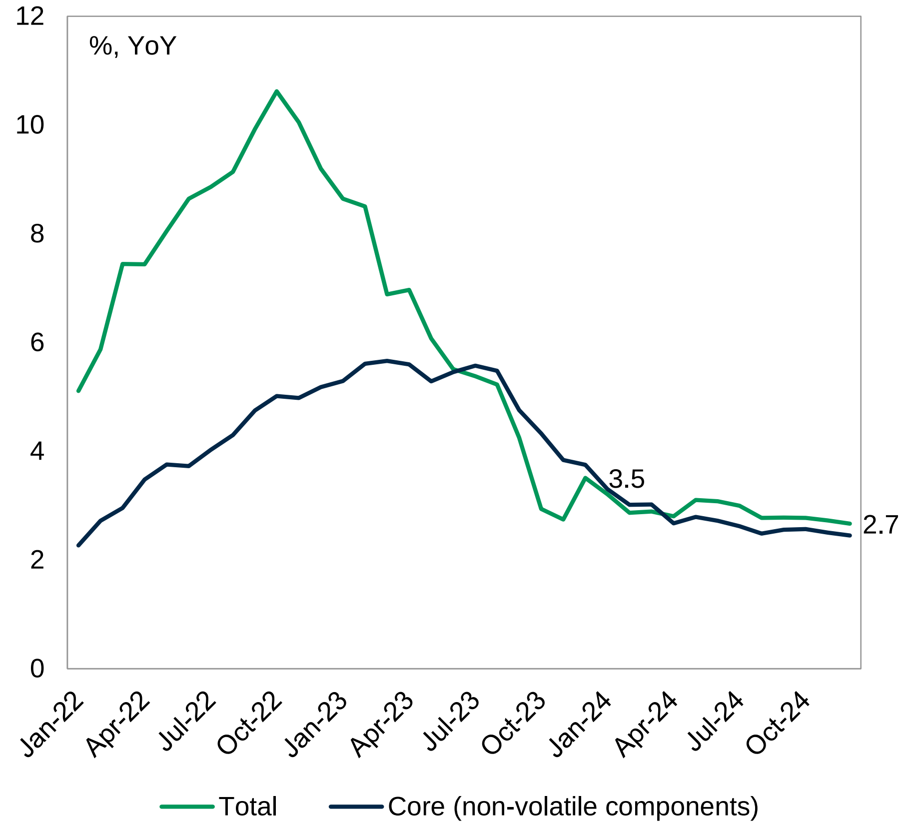
PULLED BY DOMESTIC FACTORS

Contributions to headline inflation



Sources: Eurostat, Crédit Agricole SA/ECO

Inflation forecasts

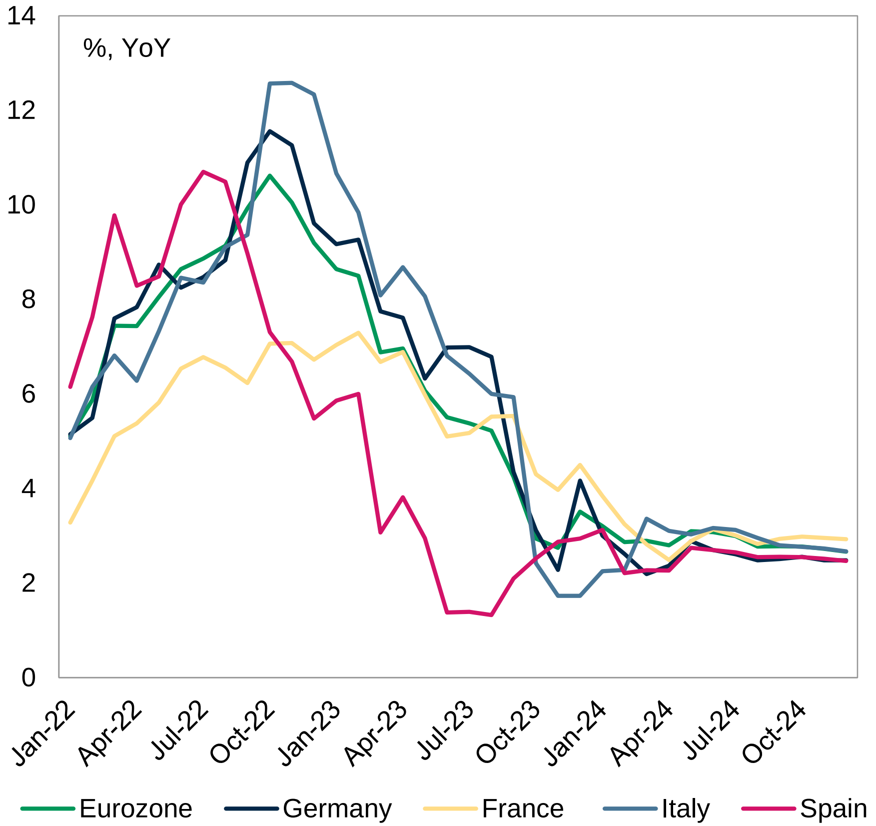


Sources: Eurostat, Crédit Agricole SA/ECO

CORE INFLATION PERSISTENCE

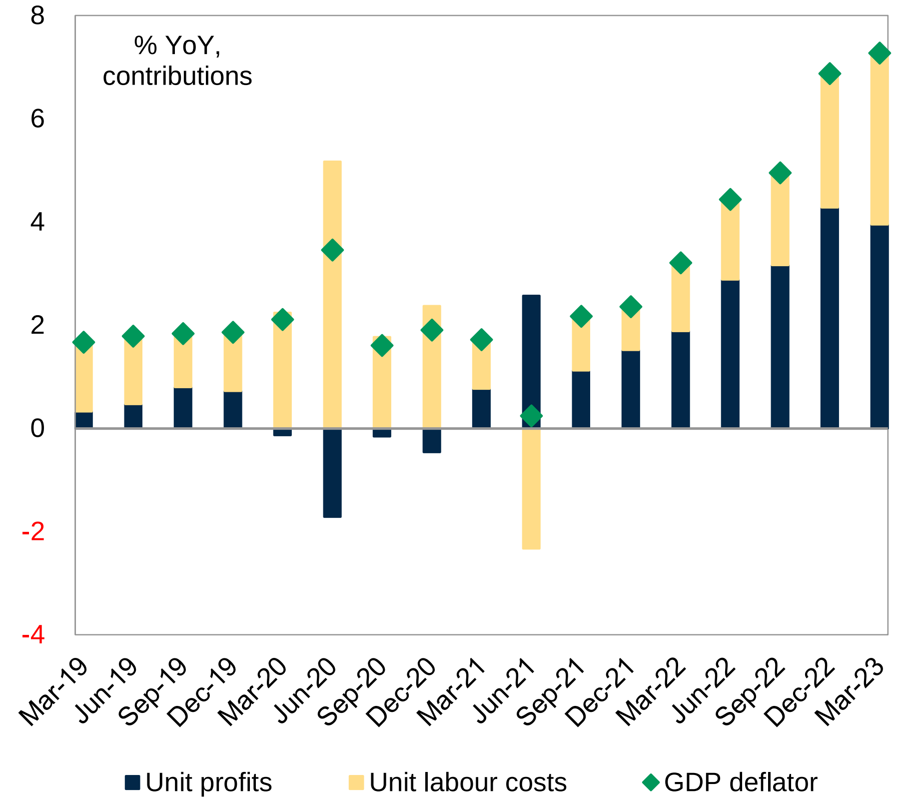
RISK OF A PRICE-WAGES-PROFITS SPIRAL

Inflation forecasts



Sources: Eurostat, Crédit Agricole SA/ECO

Domestic inflation: wages and profit margins

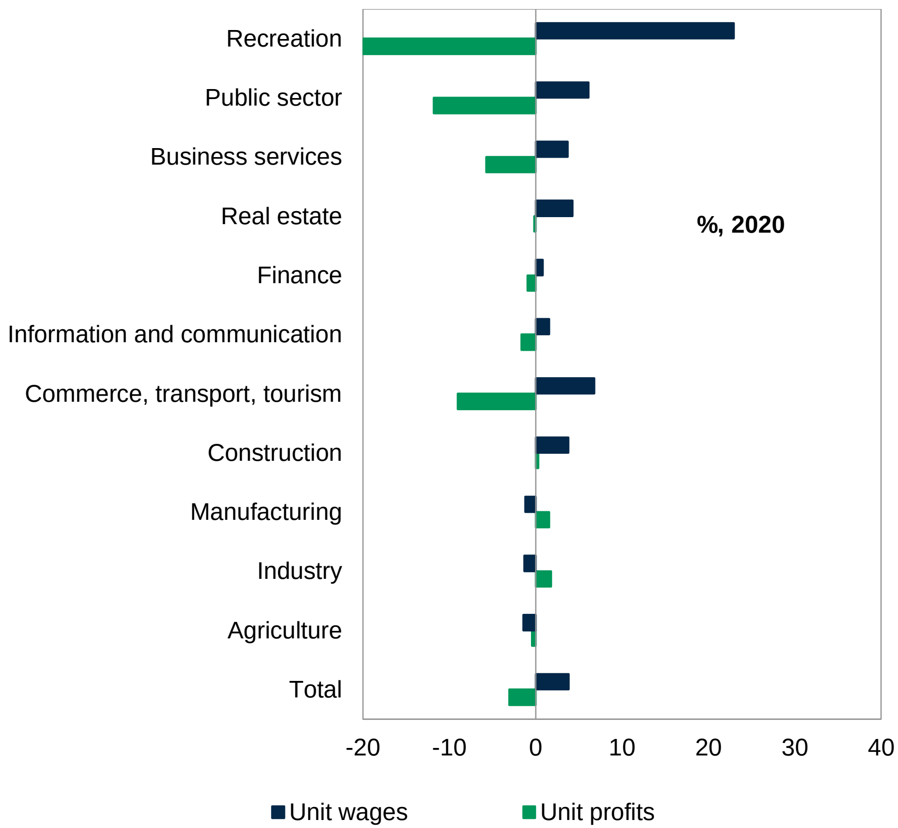


Sources: Eurostat, Crédit Agricole SA/ECO

INCREASE IN PROFITS AND CORE INFLATION PERSISTENCE

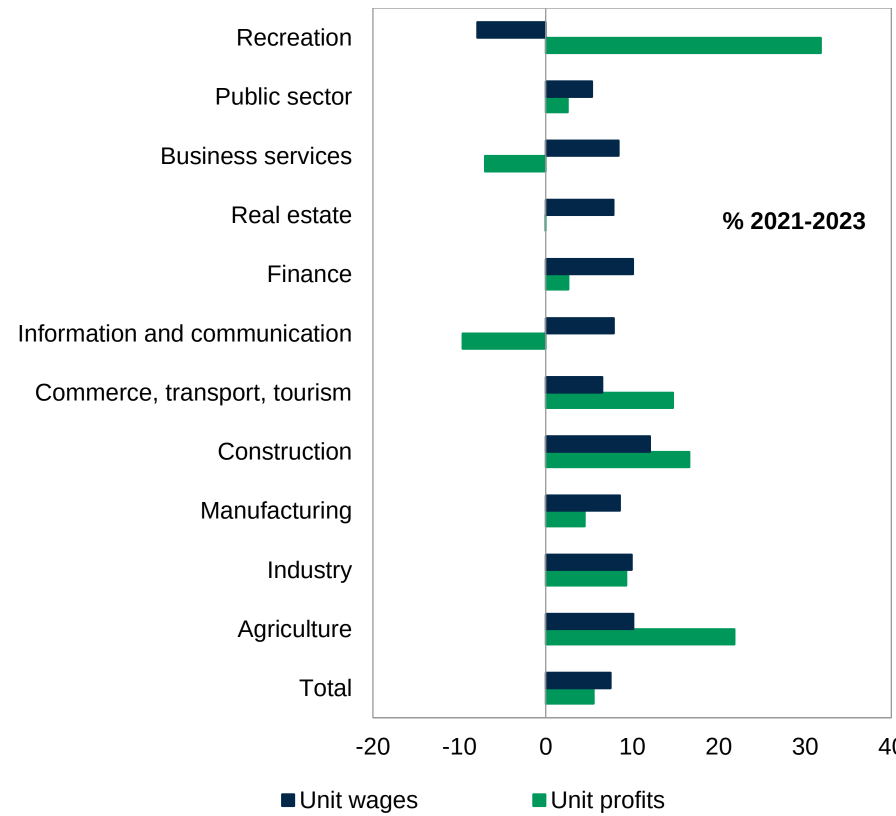
PROFITS : UNDER SCRUTINY BY THE ECB

During Covid



Sources: Eurostat, Crédit Agricole SA/ECO

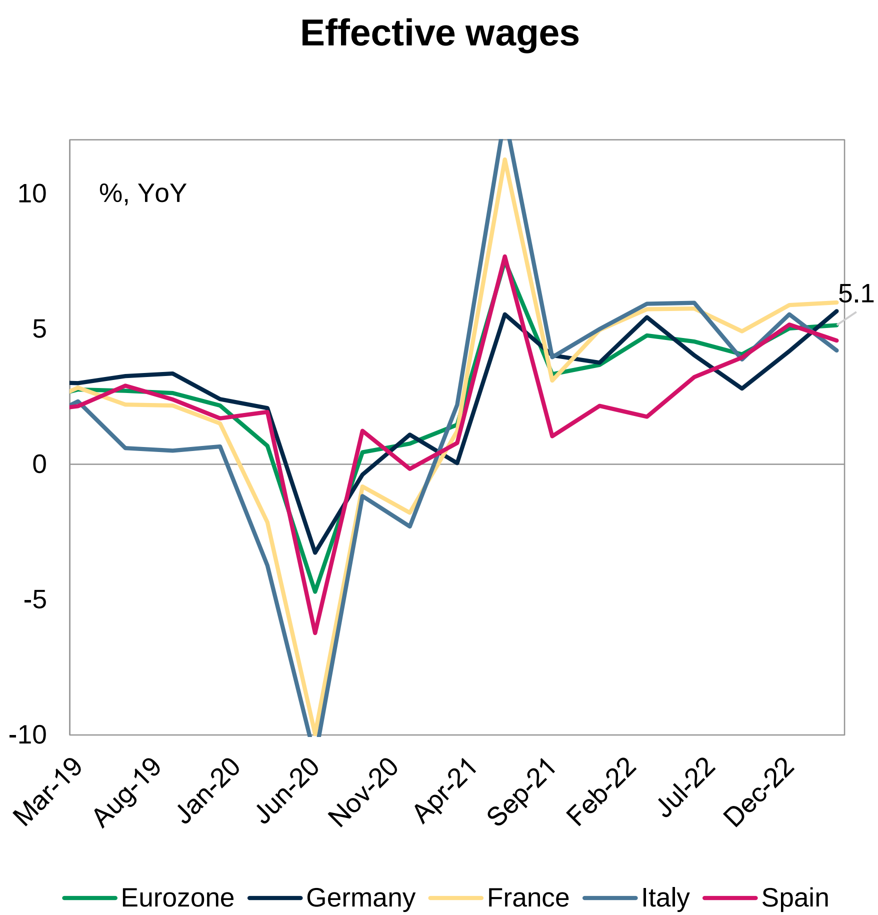
Post-Covid recovery



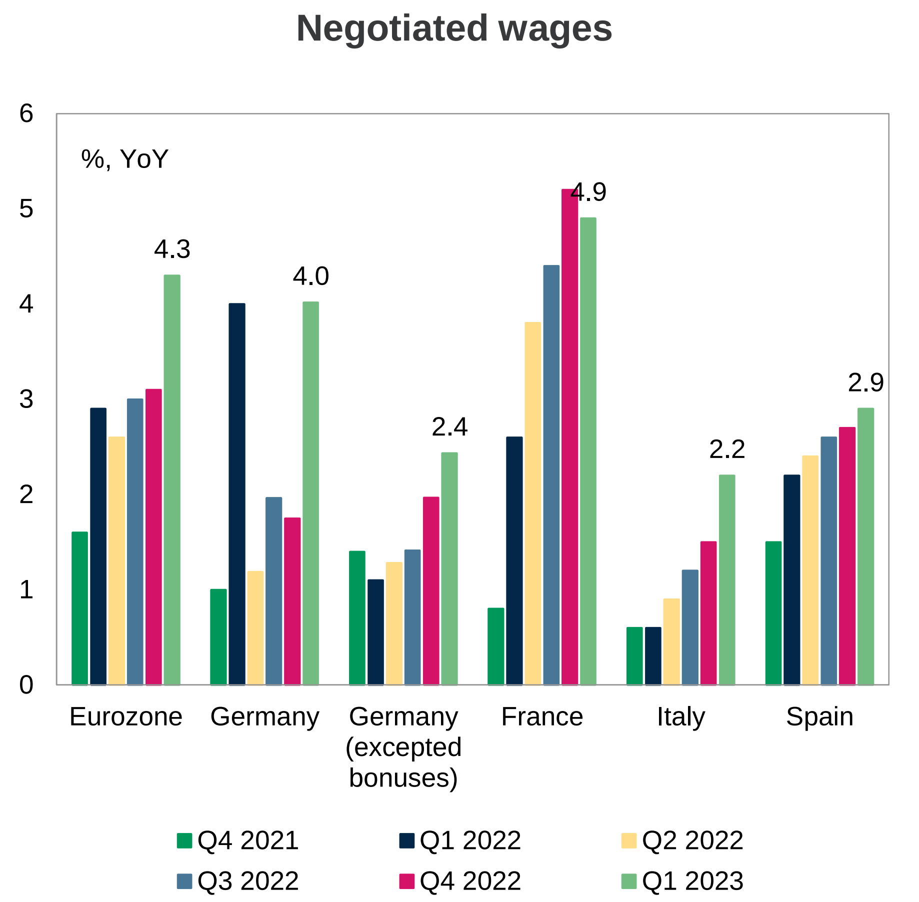
Sources: Eurostat, Crédit Agricole SA/ECO

RECOVERY IN REAL WAGES AND CORE INFLATION PERSISTENCE

DELAYED AND INCOMPLETE COMPENSATION FOR INFLATION



Sources: Eurostat, Crédit Agricole SA/ECO



Sources: Eurostat, Crédit Agricole SA/ECO

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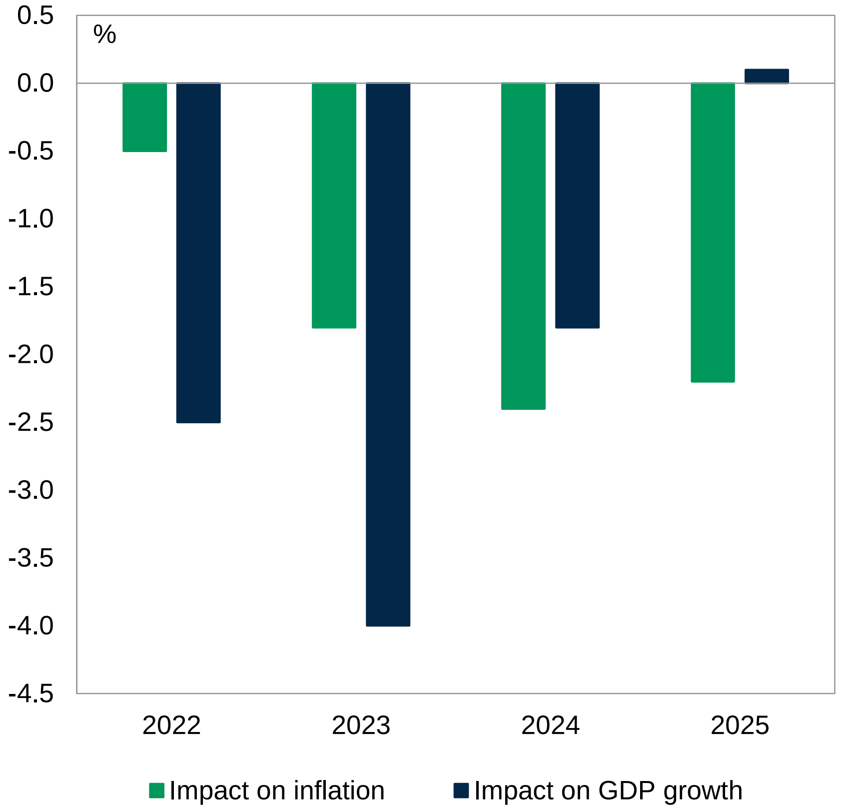
POLICY-MIX : FROM AN EXCEPTIONAL SUPPORT TO A RESTRICTIVE STANCE

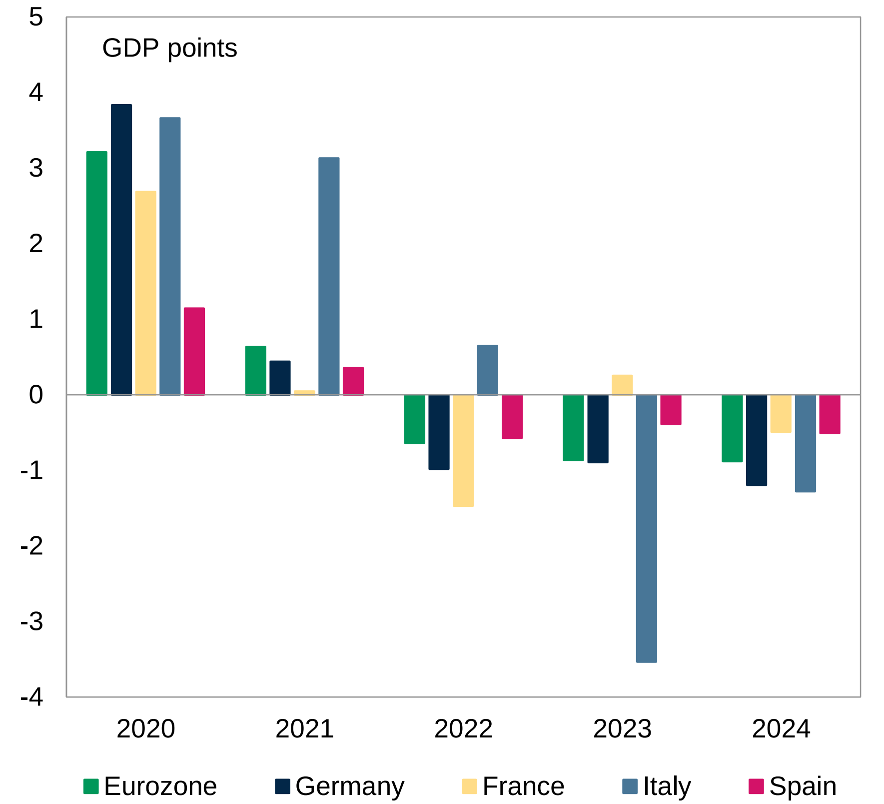
THE SHIFT IN MONETARY POLICY IS PRECEDING THE ONE IN FISCAL POLICY

Impact of monetary tightening not yet fully deployed



Sources: Eurostat, Crédit Agricole SA/ECO

Restrictive fiscal impulse

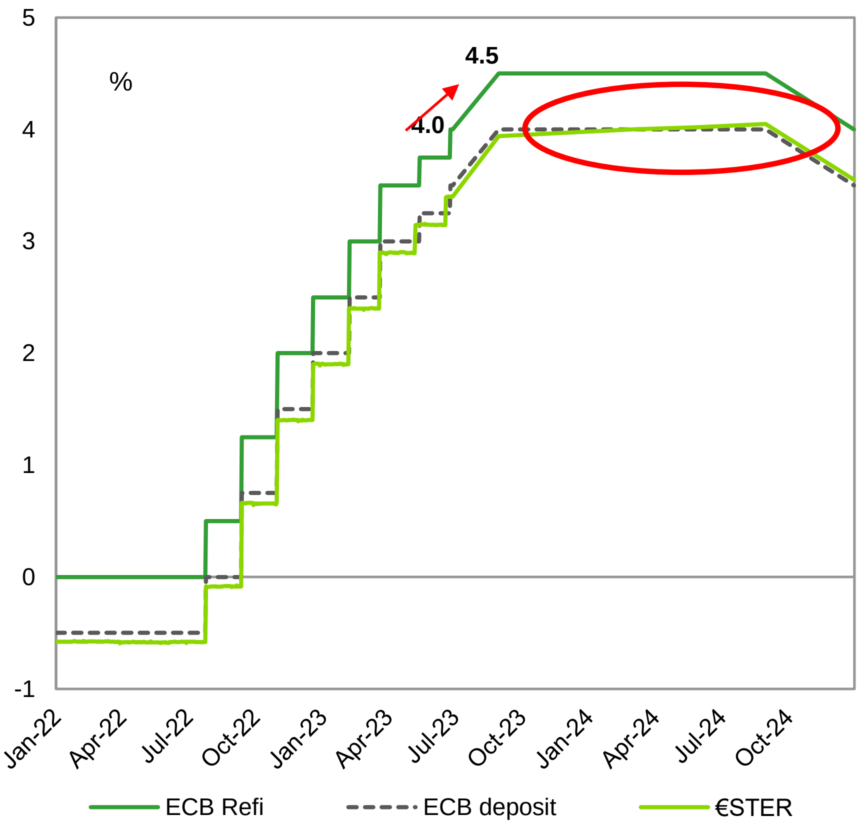


Sources: Eurostat, Crédit Agricole SA/ECO

ECB : NOT SATISFIED, YET

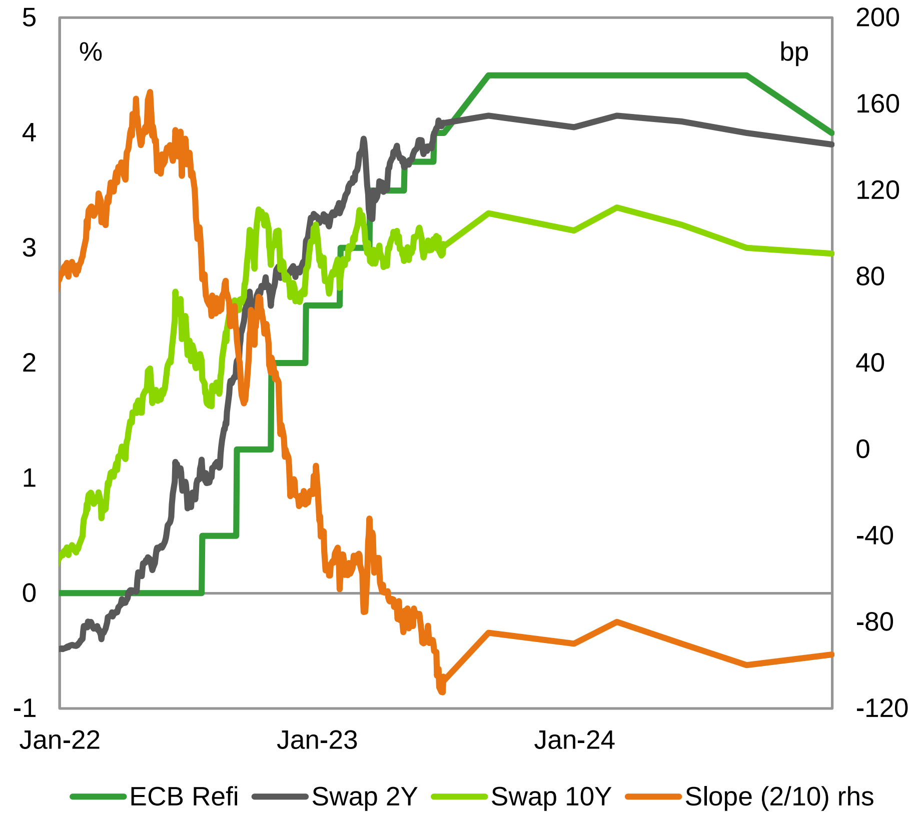
RESTRICTIVE MONETARY POLICY AND POSTPONED EASING

No monetary easing before end-2024



Sources: Bloomberg, CACIB, Crédit Agricole SA/ECO

Monetary tightening fully integrated and inversed slope

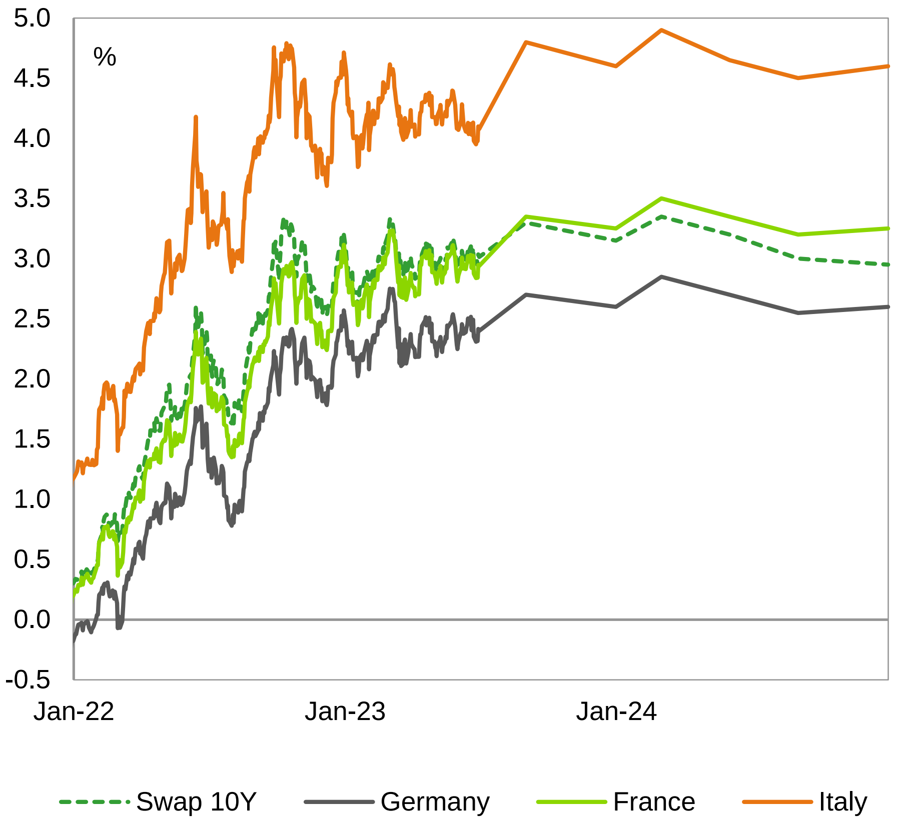


Sources: Bloomberg, CACIB, Crédit Agricole SA/ECO

LONG-TERM RATES

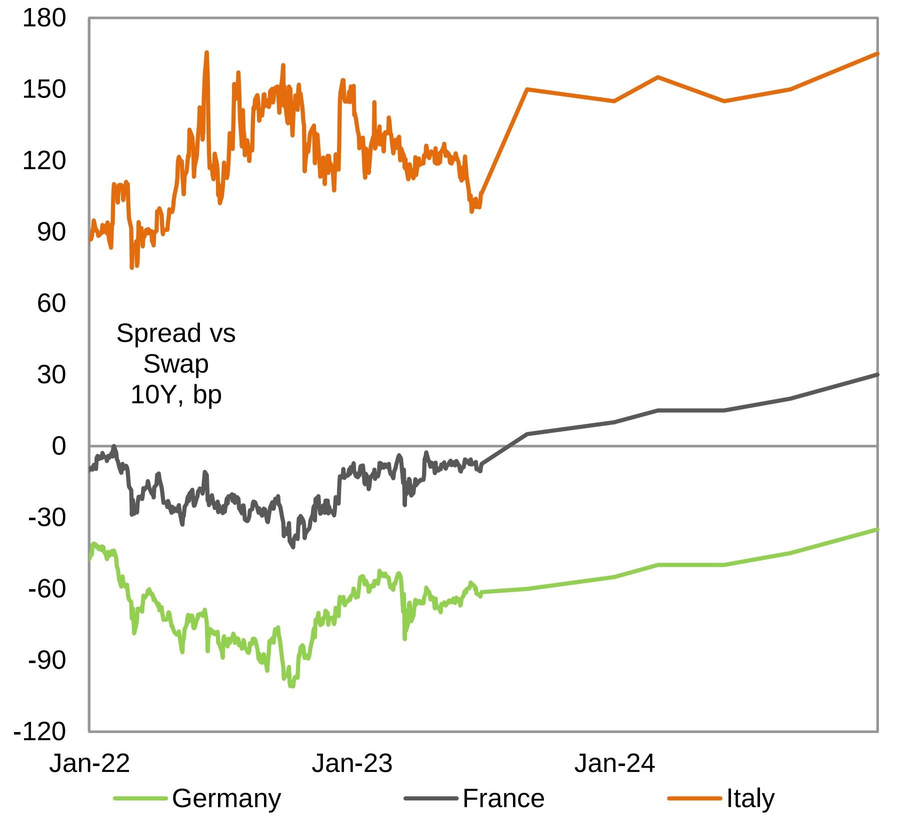
NO RISK OF ABRUPT INCREASE IN YIELDS, UNLESS INFLATION SURPRISE

Moderate increase in sovereign rates



Sources: Bloomberg, CACIB, Crédit Agricole SA/ECO

Limited widening of sovereign spreads



Sources: Bloomberg, CACIB, Crédit Agricole SA/ECO

CONSULT OUR LAST PUBLICATIONS

Date	Title	Theme
13/07/2023	United Kingdom – 2023-2024 Scenario: persistent inflation and resilient demand defy the BoE	United-Kingdom
12/07/2023	France – 2023-2024 Scenario: growth wobbles despite dipping inflation	France
30/06/2023	World – Macro-economic Scenario 2023-2024: normalisation plays hard to get	World
03/05/2023	Italy – 2023-2024 Scenario: 2023, the year of slowdown	Italy
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