



EUROZONE SCENARIO 2024-2025

SOFT LANDING ON SLUGGISH GROWTH

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**WORKING EVERY DAY
IN YOUR INTEREST**



GROUP ECONOMIC RESEARCH

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SUMMARY

SOFT LANDING ON SLUGGISH GROWTH

The recovery in domestic demand and disinflation are taking us a step further away from the stagflationary scenario that many commentators were still predicting a few months ago, or even just a few weeks ago. A slight fall in GDP in the third quarter, continued positive employment growth and a sharp fall in inflation in November continue to provide further arguments in favour of our soft landing scenario, a marked slowdown cushioned by the disinflationary process. However, higher real interest rates, a structural competitiveness shock linked to energy, and a highly uncertain external environment mean that the Eurozone economy is landing on a growth path that is below its weakened potential compared with the pre-pandemic period. Growth in the Eurozone will be capped at 0.5% in 2023, 0.7% in 2024 and 1.4% in 2025.

The stagflationary scenario is relegated to a risk scenario, since domestic sources of inflation are drying up and only a supply shock linked to the geopolitical context could cause inflation expectations to deviate from their

anchorage around the ECB target.

On the other hand, a shift towards a recession scenario is more likely than the stagflationary scenario. It does not require an external shock, but simply a deviation from the favourable assumptions on which our central scenario is based: continued disinflation, sustained activity and employment, gains in the purchasing power of wages, easing of financing conditions.

A more powerful impact of monetary tightening, resulting in weaker growth, erosion of income and profits and deterioration in the asset quality of fragile players, would fuel greater risk aversion, contributing to maintaining tight financing conditions and fuelling a vicious circle unfavourable to activity.

Our central scenario of a gradual recovery in growth sees the pace of growth capped by weak external demand in an increasingly uncertain international environment marked by the slowdown in the US and Chinese economies. On the other hand, monetary transmission is still

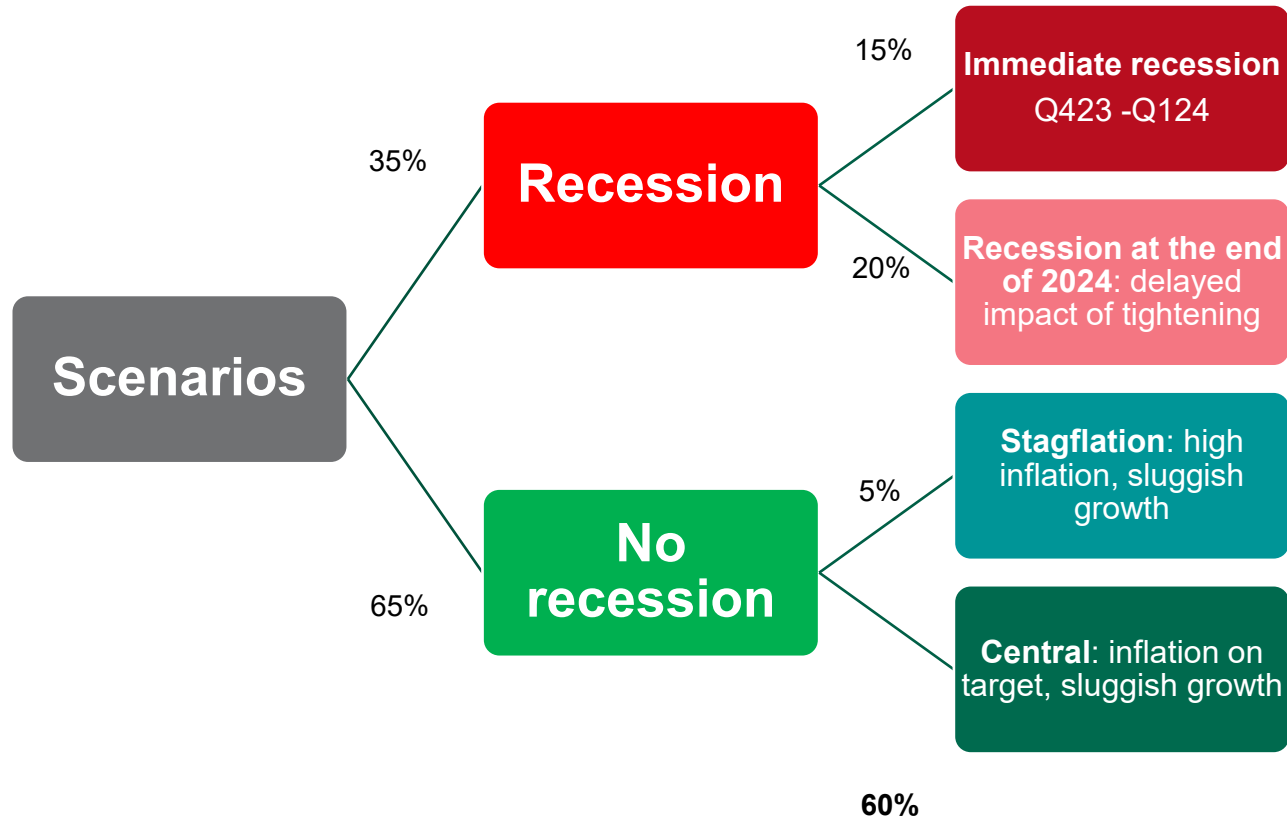
being deployed throughout 2024 (with a transmission lag of twelve to eighteen months after the last rate hike in September 2023), with its negative impact on residential investment and its drag on productive investment. Total investment growth will be positive (0.9% in 2024 and 1.8% in 2025), but well below the 2014-2019 average.

The recovery in domestic demand will be driven mainly by the upturn in private consumption (1.1% in 2024 and 1.3% in 2025). The slight and temporary increase in the unemployment rate (6.7% in 2024 and 6.6% in 2025 after 6.6% in 2023) will not derail this rebound based on an increase in the wage bill and its purchasing power. Households will also be able to draw on substantial accumulated savings, which will no longer be fuelled by precaution as soon as the disinflationary dynamic helps to improve confidence.

On the other hand, the fiscal stance will become more restrictive, with all support (Covid and energy) definitively withdrawn from 2024.

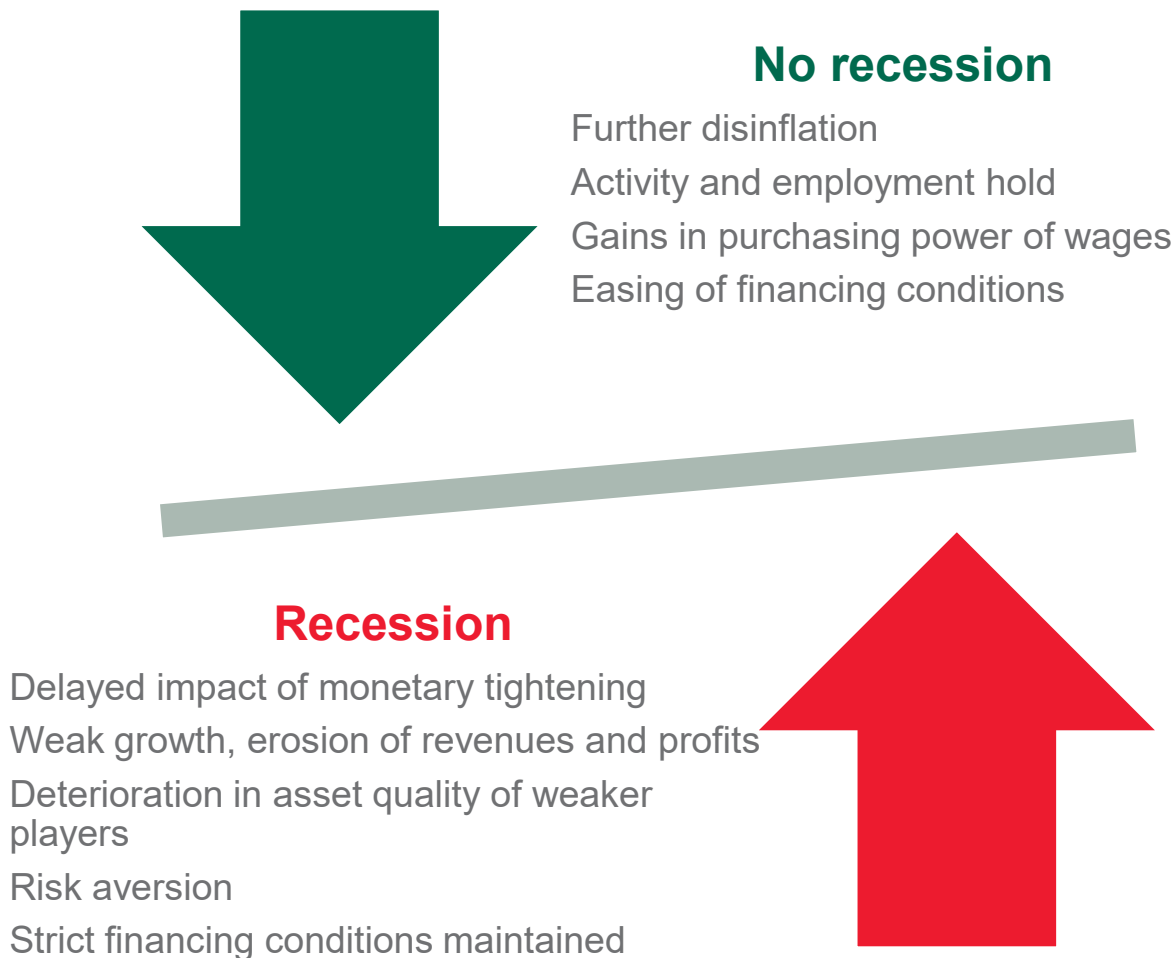
SUMMARY

SOFT LANDING AND STAGFLATION AVOIDED



SUMMARY

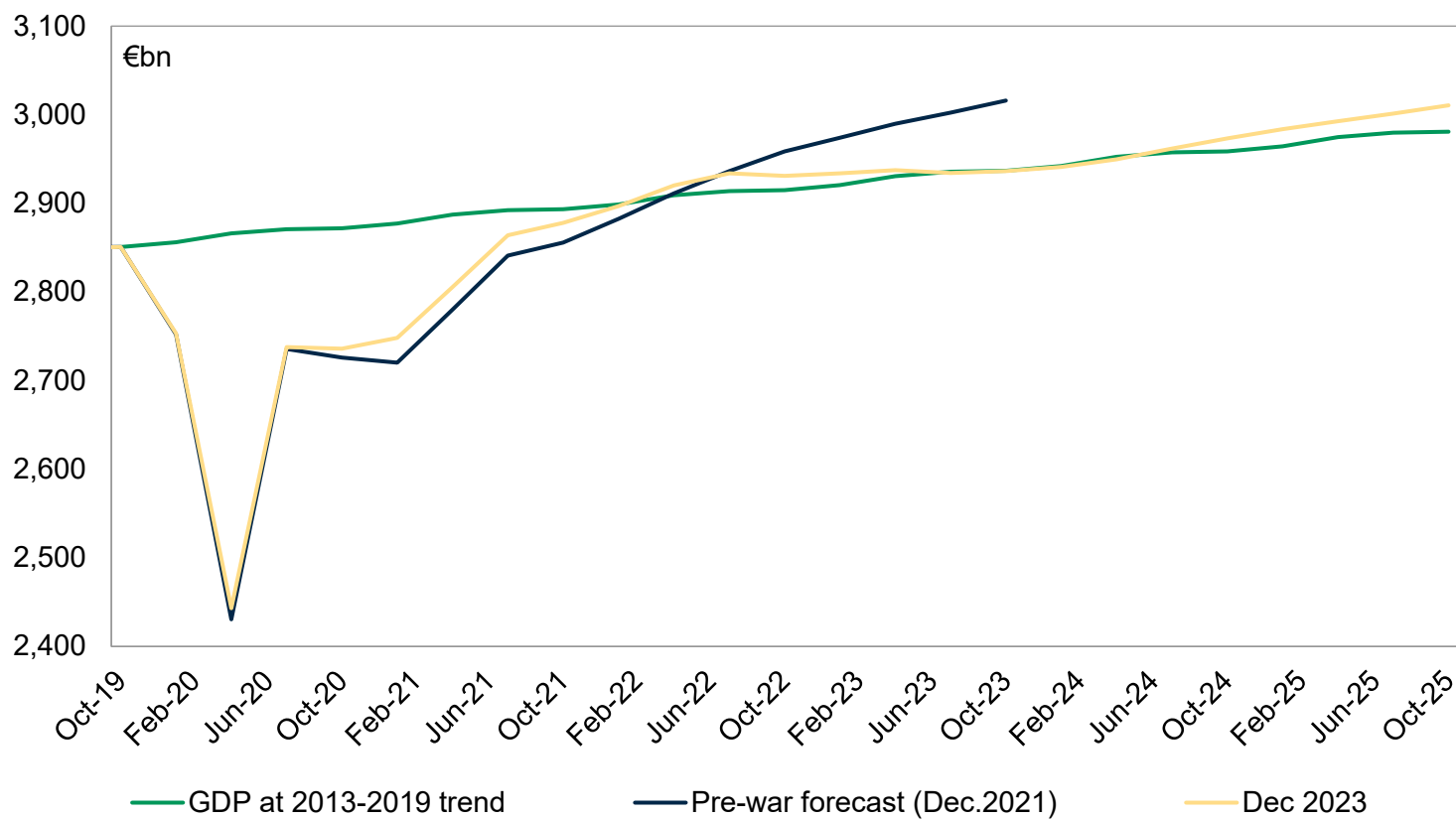
NEITHER STAGFLATION NOR RECESSION: AT WHAT CONDITIONS?



SUMMARY

INFLATION NEAR TARGET, GROWTH BELOW POTENTIAL

GDP: sluggish growth



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

OUR FORECASTS

EUROZONE AGGREGATE

Quarterly rate (QoQ, %)													Annual rate (YoY, %)			
EMU	2023				2024				2025				2022	2023	2024	2025
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
GDP	0,1	0,1	-0,1	0,0	0,2	0,3	0,4	0,4	0,3	0,3	0,3	0,3	3,4	0,5	0,7	1,4
Households consumption	0,1	0,0	0,3	0,2	0,3	0,4	0,4	0,5	0,3	0,2	0,2	0,2	4,2	0,5	1,2	1,3
Public consumption	-0,5	0,2	0,4	0,8	0,1	0,1	0,3	0,2	0,1	0,1	0,1	0,1	1,6	0,4	1,2	0,6
Total GFCF	0,4	-0,1	0,0	-1,0	0,1	0,3	0,4	0,5	0,5	0,4	0,5	0,5	2,8	0,5	-0,1	1,9
G&S exports	-0,4	-1,1	-1,1	-0,9	0,3	0,7	0,8	0,8	0,7	0,6	0,7	0,7	7,3	-1,1	-0,1	2,8
G&S imports	-1,6	0,0	-1,2	-1,4	0,3	0,7	0,8	0,9	0,7	0,6	0,6	0,6	7,9	-1,8	-0,2	2,8
Inventory changes (% of GDP)	0,3	1,0	0,7	0,4	0,4	0,4	0,4	0,4	0,4	0,4	0,4	0,4	0,9	0,6	0,4	0,4
<i>Contributions to GDP growth</i>																
Domestic demand excluding inventories	0,0	0,0	0,2	0,1	0,2	0,3	0,4	0,4	0,3	0,2	0,2	0,2	3,1	0,5	0,9	1,2
Inventories	-0,5	0,7	-0,3	-0,3	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,3	-0,2	-0,2	0,0
Net exports	0,6	-0,6	0,0	0,2	0,0	0,0	0,0	0,0	0,0	0,1	0,1	0,1	0,0	0,3	0,0	0,1
Unemployment	6,6	6,5	6,5	6,7	6,8	6,8	6,7	6,7	6,7	6,6	6,5	6,6	6,7	6,6	6,7	6,6
Consumer prices	8,0	6,2	4,9	2,7	2,6	2,5	2,4	2,8	2,7	2,5	2,3	2,2	8,4	5,4	2,6	2,4
Unemployment	6,6	6,5	6,5	6,7	6,8	6,8	6,7	6,7	6,7	6,6	6,5	6,6	6,7	6,6	6,7	6,6
Current account (% of GDP)													3,3	2,7	3,8	1,4
Budget balance (% of GDP)													-3,8	-3,4	-3,1	-2,8
Fiscal impulse													-0,6	-0,9	-0,8	-0,1

OUR FORECASTS

EUROZONE BY COUNTRY

Quarterly rate (QoQ, %)													Annual rate (YoY, %)			
Eurozone	2023				2024				2025				2022	2023	2024	2025
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Eurozone	0,1	0,1	-0,1	0,0	0,2	0,3	0,4	0,4	0,3	0,3	0,3	0,3	3,4	0,5	0,7	1,4
Germany	0,0	0,1	0,0	-0,3	-0,1	0,0	0,3	0,3	0,3	0,2	0,2	0,2	1,9	-0,1	-0,1	1,0
France	0,1	0,6	-0,1	0,2	0,2	0,3	0,4	0,4	0,4	0,3	0,3	0,4	2,5	0,9	1,0	1,3
Italy	0,6	-0,4	0,1	0,1	0,2	0,2	0,3	0,4	0,2	0,2	0,0	0,2	3,9	0,7	0,6	0,9
Spain	0,6	0,4	0,3	0,2	0,4	0,4	0,5	0,3	0,4	0,2	0,2	0,1	5,8	2,4	1,6	1,4
Netherlands	-0,5	-0,4	-0,2	0,2	0,3	0,3	0,3	0,3	0,2	0,4	0,4	0,4	4,4	0,2	0,7	1,2
Belgium	0,4	0,3	0,4	0,1	0,3	0,3	0,4	0,4	0,3	0,2	0,2	0,3	3,0	1,4	1,2	1,2
Ireland	-1,9	-0,4	-1,9	-0,9	0,3	1,3	1,5	1,5	1,5	1,7	1,6	1,6	9,5	-2,2	0,7	6,4
Portugal	1,5	0,1	-0,2	-0,3	0,4	0,8	0,8	0,4	0,5	0,6	0,4	0,3	6,8	2,0	1,2	2,1
Greece	0,1	1,1	0,0	0,1	0,6	0,7	0,4	0,6	0,6	0,5	0,3	0,2	5,7	2,0	1,8	2,1
Finland	0,1	0,4	-0,9	0,2	0,2	0,3	0,4	0,4	0,4	0,3	0,4	0,4	1,6	-0,4	0,6	1,5
Luxembourg	0,6	-0,1	0,3	0,3	0,3	0,4	0,4	0,4	0,4	0,4	0,4	0,4	1,4	-0,9	1,2	1,7
Austria	0,1	-1,1	-0,5	0,2	0,4	0,6	0,6	0,5	0,2	0,1	0,3	0,3	4,8	-0,7	0,9	1,3
Slovenia	0,2	1,0	-0,2	0,1	0,6	0,9	0,8	0,7	0,4	0,3	0,7	0,6	2,9	1,4	2,0	2,2
Malta	0,5	1,9	2,4	0,5	0,5	0,5	0,6	0,6	0,3	0,7	1,0	0,9	8,2	6,2	3,4	2,4

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RECENT DEVELOPMENTS

IMPROVED PURCHASING POWER TRANSLATES INTO INCREASED CONSUMPTION

Despite its slight decline in the third quarter of 2023 (-0.1% Q3/Q2), GDP growth provides a rather comforting picture of the zone's economy. Domestic demand has recovered and, after the decline at the end of 2022 and a sluggish first half, is once again making a positive contribution to GDP growth (0.2 points) thanks to the rebound in private consumption (+0.3%) and the acceleration in public consumption (+0.3%). Investment, on the other hand, stagnated: the positive growth in investment in machinery and equipment and in transport barely offset the fall in investment in construction. The latter was particularly affected by the fall in residential investment, while investment in other types of construction has shown slightly negative growth for the past two quarters.

The weakness of global demand is reflected in external demand for the Eurozone, which is continuing to fall at a sustained rate, while the fall in demand for inventories and investment is holding back imports. The contribution of net foreign demand was

therefore null, with exports and imports falling at the same rate (-1.1% and -1.2% respectively).

Finally, **strong destocking subtracted 0.3 points from growth, reducing the level of inventories after the large build-up recorded in the second quarter of 2023** (with a contribution of +0.7 points). Inventories had enabled positive growth to be posted in the second quarter, despite sluggish domestic demand and a strongly negative contribution from net foreign demand. Although the level of inventories relative to GDP is still high, its recent fall bodes well for growth in the coming quarters.

Continued growth in employment (0.2% over the quarter) and the acceleration in wages per employee (1.3%, after 0.7%) continued to support household disposable income in the Eurozone in the third quarter of 2023. Disposable income continued the slowdown that began in Q2, but still grew at a sustained rate (0.9% over the quarter, after 1.1%).

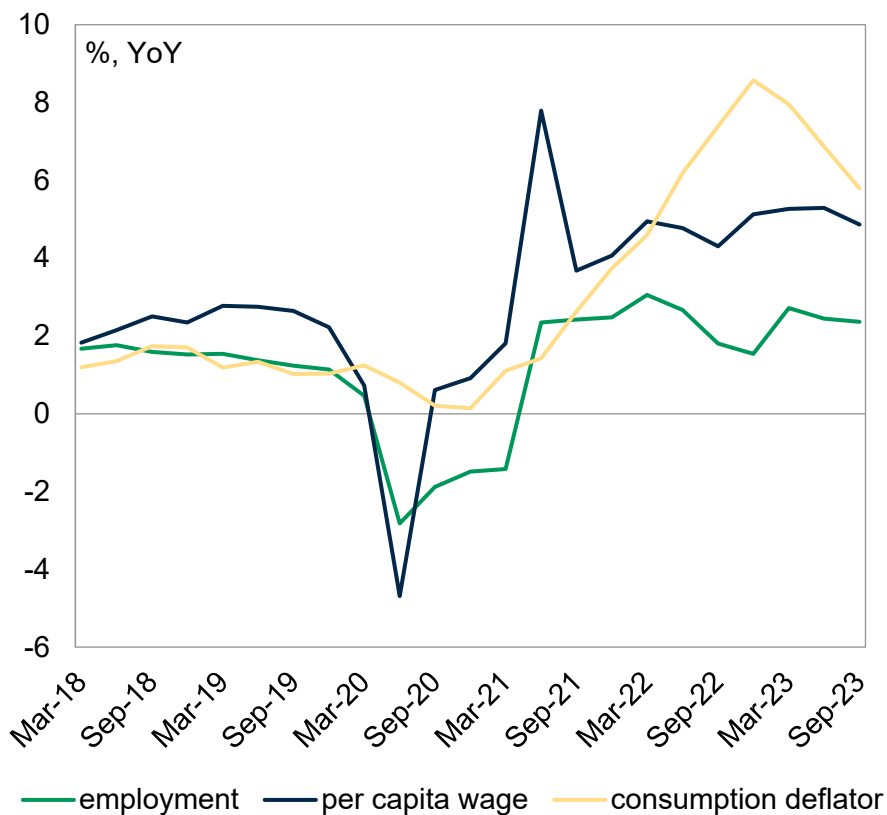
Household consumption grew faster than disposable income, supported by **a fall in the savings rate (to 14%).** Since the first quarter of 2023, wages per employee have risen faster than inflation. This gain in purchasing power coincides with an improvement in household confidence, and has been reflected for the past two quarters in a fall in the savings rate.

On the other hand, household investment spending continues to contract (-0.1% over the quarter), albeit at a slower rate. The household investment rate continues the decline that has been underway since spring 2022 (to 9.7% of gross disposable income), leaving net lending up at 4.5% of gross disposable income. Although financial investment is falling, the fall in financing is more significant, with a very marked slowdown in lending in particular. **Financial and property wealth fell as a percentage of disposable income, eroding net wealth, despite the reduction in debt (54.4% of GDP after 57.6% a year earlier).**

RECENT ECONOMIC DEVELOPMENTS

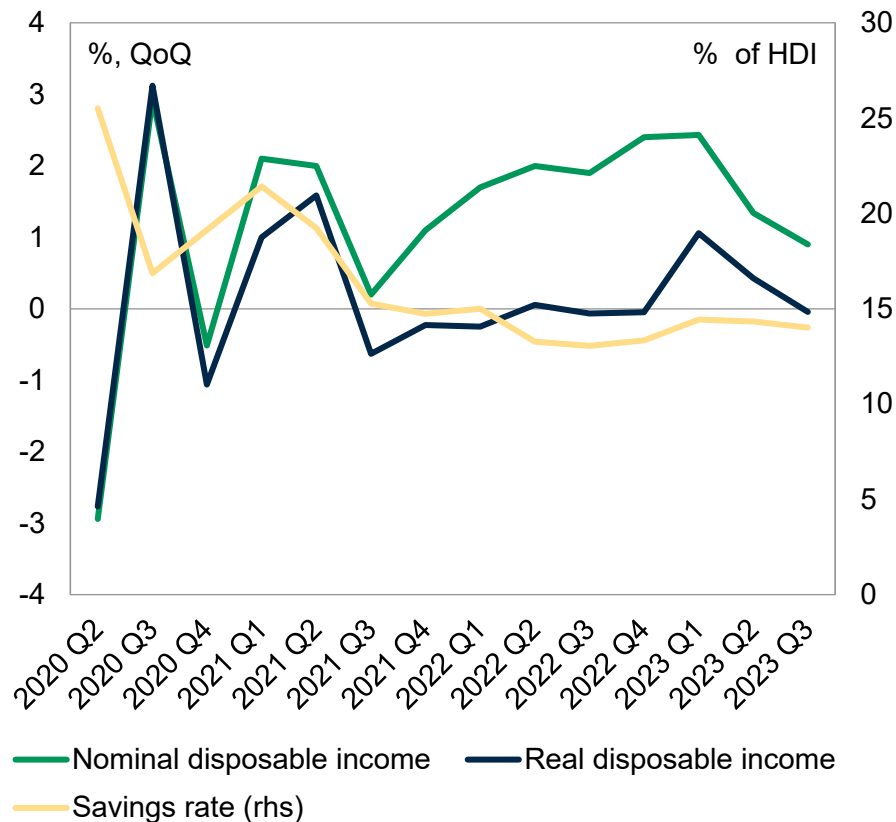
RECOVERY IN PURCHASING POWER AND CONSUMPTION

Real income up



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

Savings rate starts to fall



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

RECENT ECONOMIC DEVELOPMENTS

RISING LABOUR COSTS WEIGH ON STILL HIGH MARGINS

Firms are seeing their profitability shrink under the combined effect of rising wage costs and worsening productivity, even though input costs are falling.

After peaking in the third quarter of 2022, the profit margin of non-financial corporations continues to fall (to 40.2% of value added). **But it remains fairly high compared with its historical average.**

Employment growth has remained positive overall, but has lost momentum in industry and the number of hours worked has fallen. Although wages per employee lost some of their dynamism in the third quarter of 2023 (4.9% compared with 5.4% over one year), they are still growing at a sustained rate. The accelerating rise in wages paid has been faster than the slowing growth in value added, resulting in a more favourable distribution of earnings.

The downturn in productivity has intensified, further reducing the share distributed to profits. Although unit labour costs have barely returned to positive growth in real

terms, in nominal terms they are rising at an ever-increasing pace.

Firms once again reduced their investment spending in Q3 2023, albeit at a slower pace, and the investment rate fell (to 22.9%). This enabled them to generate greater financing capacity (at 2.6% of value added). The fall in financial investment was smaller than the fall in financing, particularly bank financing, while bond financing recovered. As a result, **corporate debt continued to fall, with the debt-to-GDP ratio at 68% (after 73.7% a year earlier).**

The deterioration in business activity in the third quarter did not lead to an increase in business insolvencies. The number of insolvencies fell in the third quarter, although they are now slightly higher than before the pandemic. While bankruptcies rose in manufacturing, they fell in services, where they had risen sharply since the pandemic.

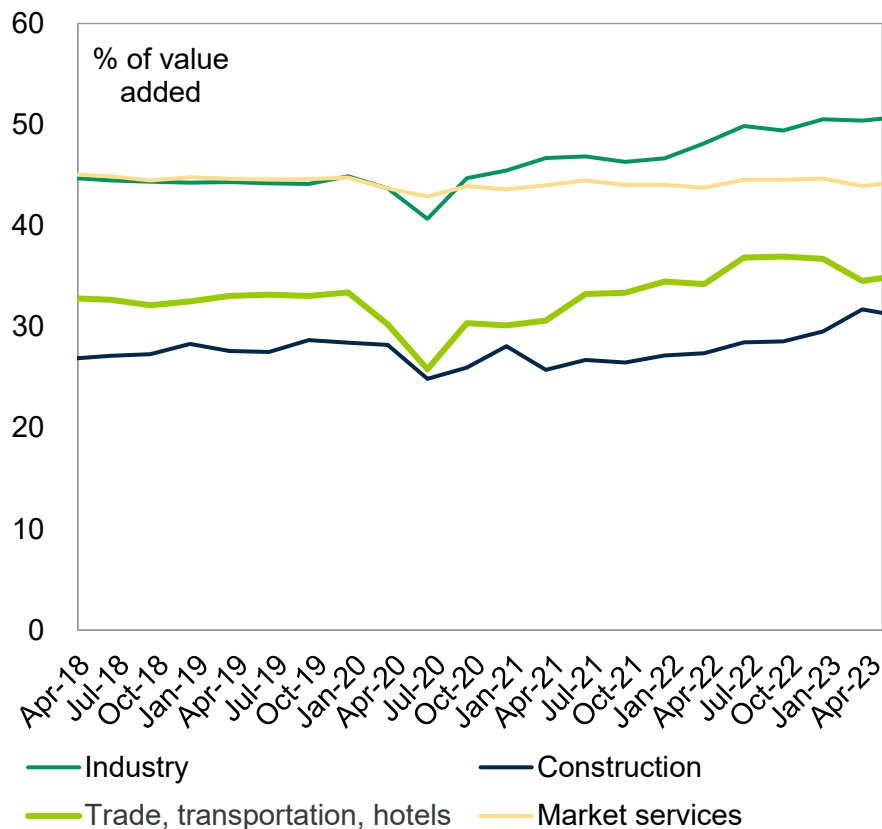
Industrial output has been on a downward trend since mid-2022. The rise in gas prices following the start of the invasion of Ukraine has had a negative impact on energy-intensive production, which failed to recover last year despite the fall in gas prices. Automobile production rebounded in 2022, but the rebound stopped in 2023 and it is now close to its pre-pandemic norm. **The further fall in industrial production in November suggests a decline in manufacturing activity in Q4 2023, adding a downside risk to our forecast of slightly positive growth (+0.1% for the quarter).**

The December surveys confirm a contraction in activity in Q4 2023 and lacklustre confidence among private agents. The PMI index points to a sharp, albeit easing, downturn in industrial activity, as well as a decline in services. In November, according to the Commission's surveys, while consumer confidence is recovering very modestly in retail trade and construction, it remains very weak in industry.

MARGINS HIGH BUT DETERIORATING

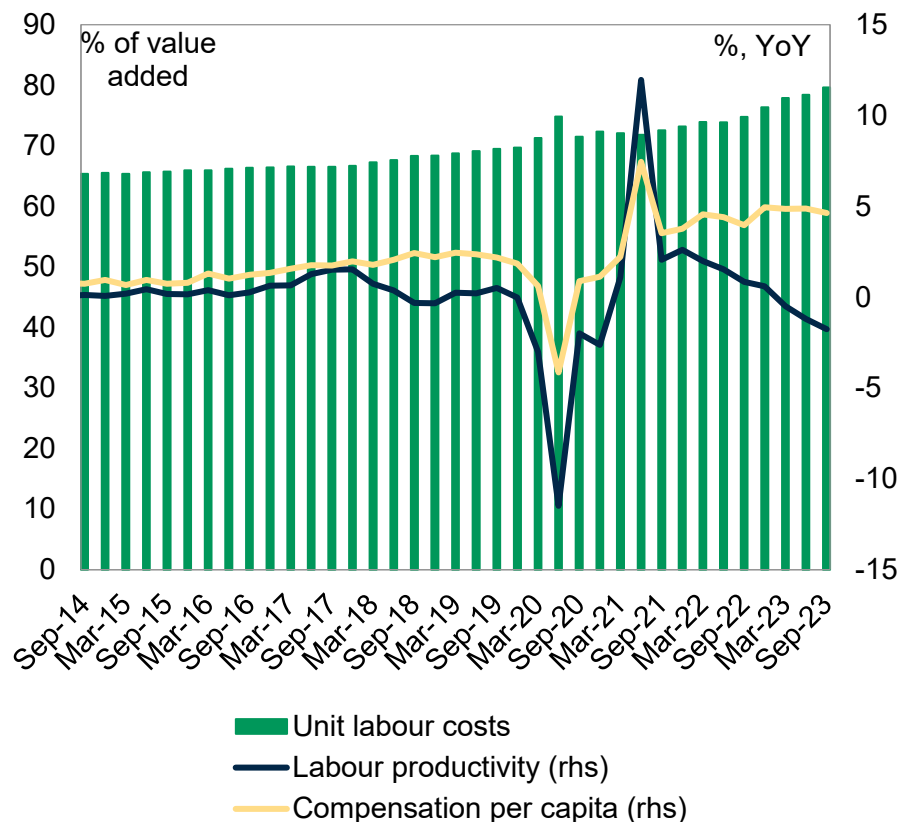
UNDER PRESSURE FROM WAGE COSTS AND FALLING PRODUCTIVITY

Margin rate: down but high



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

Rising wages & falling productivity increase unit labour costs

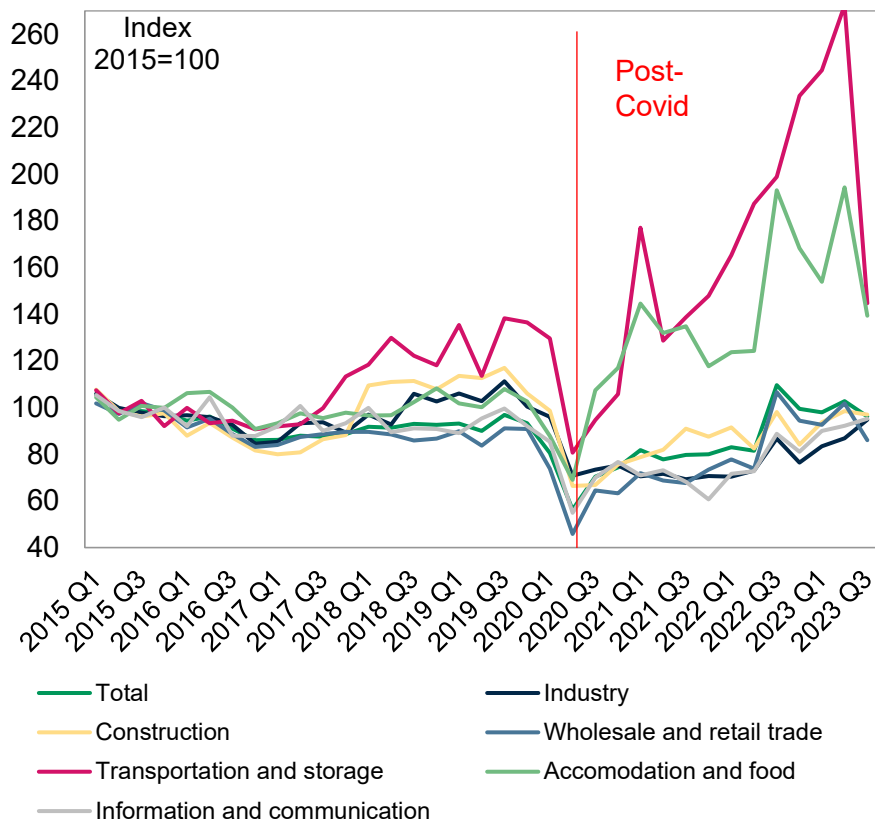


Sources: Eurostat, Crédit Agricole S.A./ECO

INCREASE IN INSOLVENCIES, BUT NO “WALL OF BANKRUPTCIES”

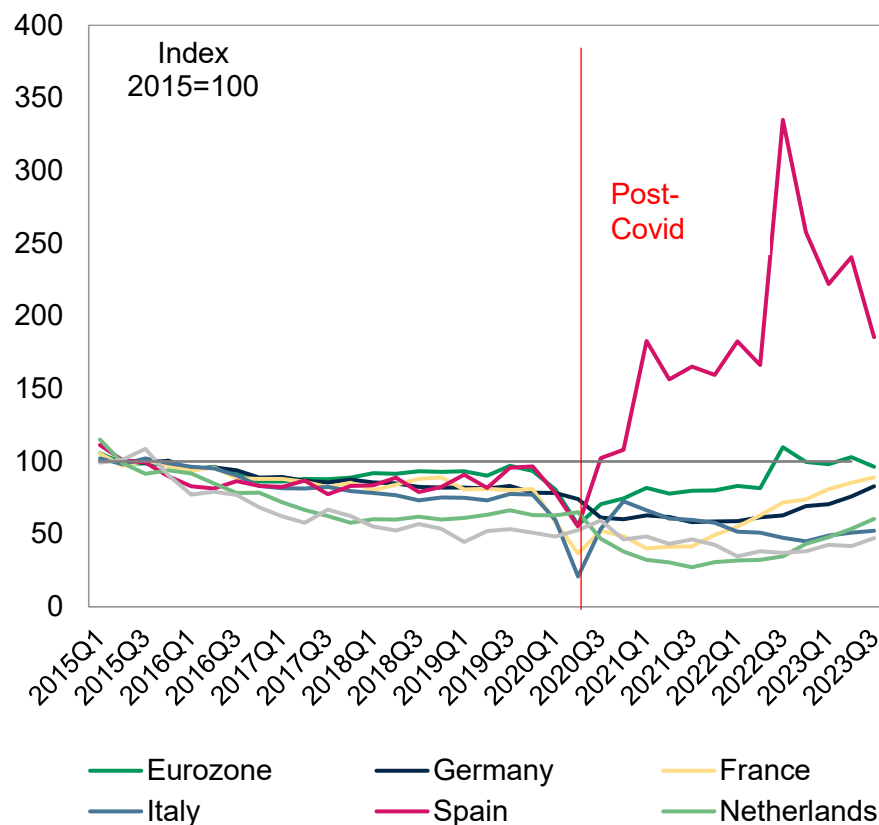
LATEST SIGNS POINT TO RESILIENCE

Eurozone: insolvencies by sector



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

Insolvencies by country



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

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SCENARIO

DISINFLATION AS A PREREQUISITE

Benefiting from significant base effects on energy prices (after peaking in Q3 2022) and all goods prices, inflation fell sharply in Q3 and Q4 2023.

After a significant fall in November 2023 (2.4%), inflation picked up again in December (2.9%). The inflation rate is expected to remain sluggish in 2024, at between 2.5% and 3% depending on the month. **At the start of the year, several factors will help to keep inflation above the ECB's target. The removal of price caps on gas and electricity and the increase in regulated tariffs have been announced in several Eurozone countries. Increases in VAT on energy, as well as on certain goods and services, are also expected.** Increases in minimum social benefits and minimum wages, and the delayed effects of their past increases, will also continue to fuel inflation.

Wage growth is expected to continue at a slower but still sustained pace (4.5% in

2024) and will continue to support domestic inflation, particularly in services. Branch negotiations representing a large number of employees (7% of the workforce, including the construction, temporary employment, chemicals and retail sectors) are expected in the first half of 2024 in Germany, with high demands for wage increases.

We expect inflation to show some inertia in 2024, remaining at 3% at the end of the year and rising to 2.2% by the end of 2025. On an annual average basis, inflation would be 2.6% in 2024 and 2.4% in 2025, after 5.4% in 2023.

Our forecasts are based on an average oil price of 87 dollars a barrel in 2024 and 88 dollars in 2025.

The ECB recently lowered its forecast for 2024 (from 3.2% to 2.7%); it continues to expect inflation to be 2.1% in 2025 and 1.9% in 2026. By Q3 2025, inflation would reach

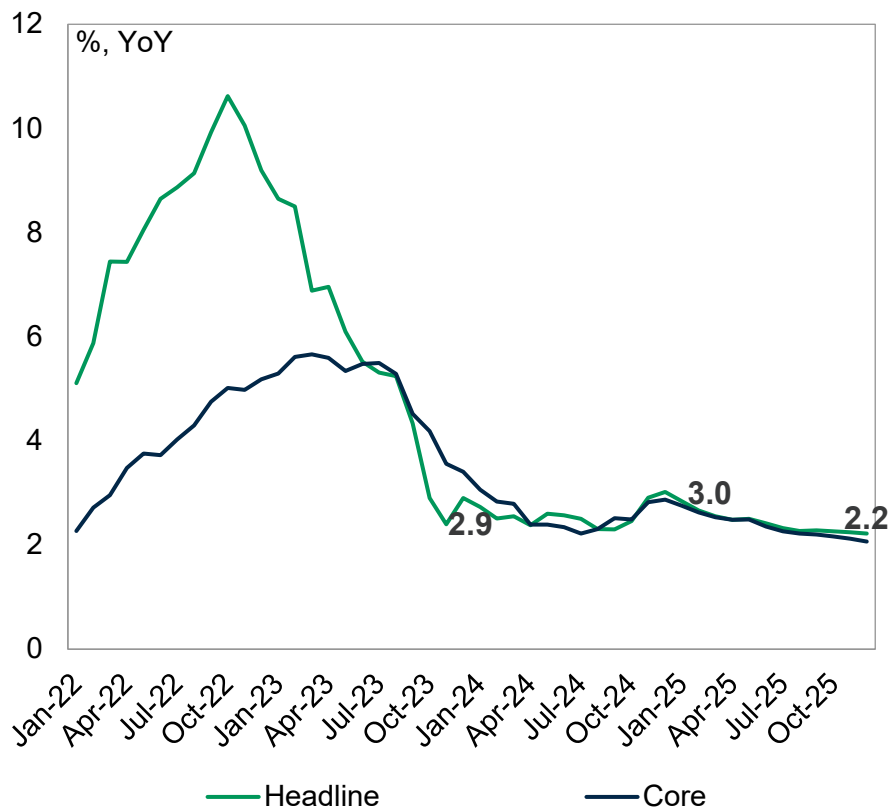
the target, i.e. around a year and a half after the last rate hike (in September 2023), which corresponds to the standard lag in the transmission of monetary policy. However, these forecasts were made before November's inflation figures were available, which, at 2.4%, are lower than expected and pose a downside risk to the ECB's Q4 2023 forecast (at 2.8%).

Economic agents' expectations have also been revised sharply downwards. This is the case for perceived inflation, as well as for inflation expectations one and three years ahead in the ECB's November consumer inflation survey. This is also the case for market expectations extracted from inflation hedging instruments, which point to a fall in inflation expectations over the last month. At this stage, the risk of a shift in expectations appears limited.

CONTINUING DISINFLATION

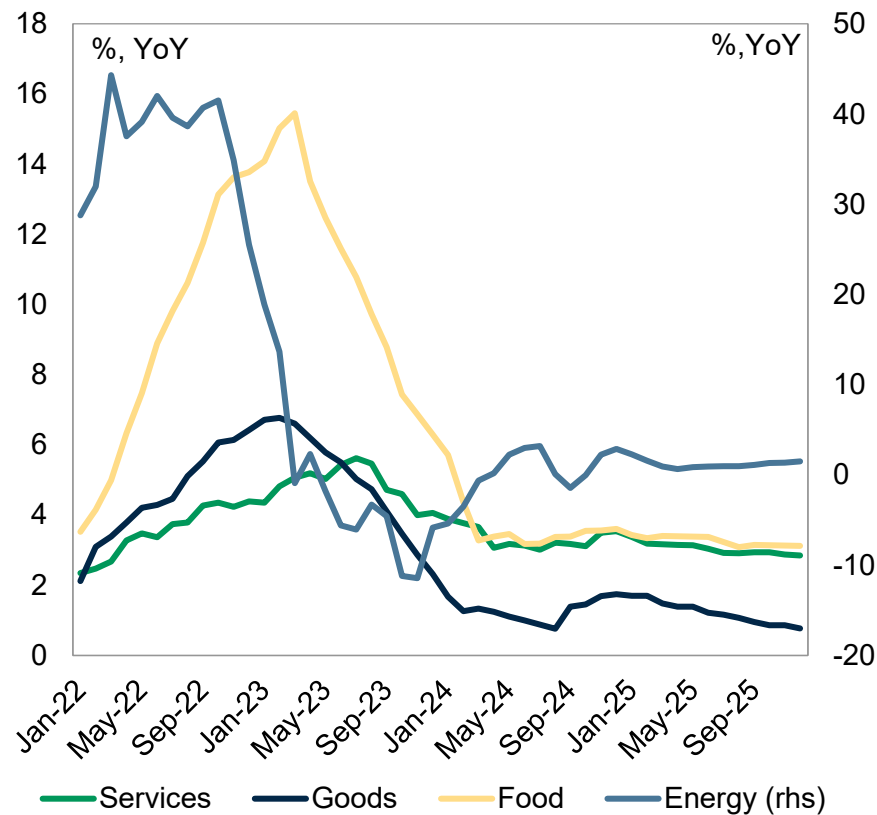
THE PREREQUISITE FOR A BENIGN SCENARIO

Inflation: resistance, then decline



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

The decline is “in the pipeline” everywhere

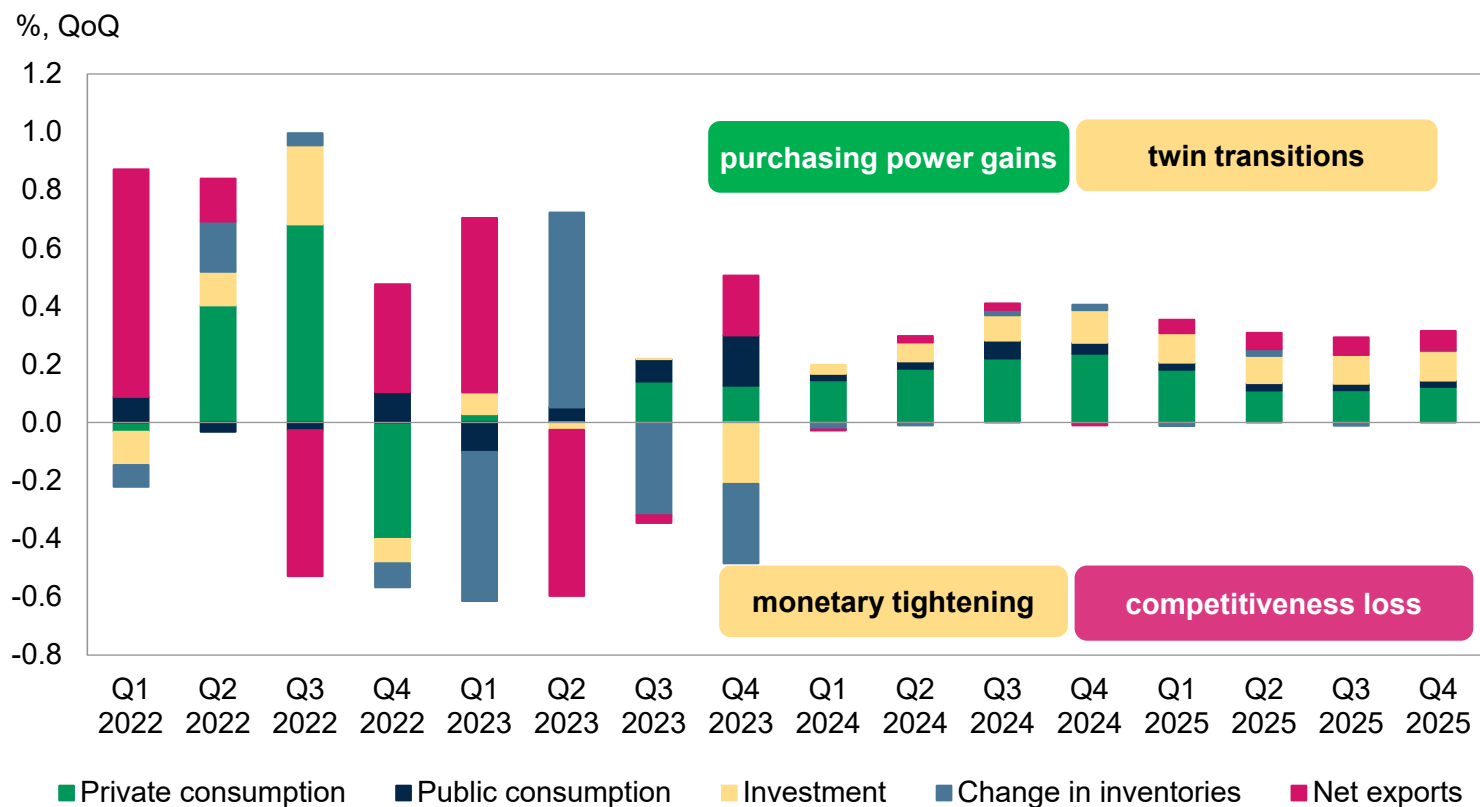


Sources: Eurostat, Crédit Agricole S.A./ECO

SCENARIO

BETWEEN THE PEAK IN MONETARY TRANSMISSION AND THE SLOWDOWN IN INFLATION

Contributions to growth and support/brake factors



Sources: Eurostat, Crédit Agricole SA/ECO

SCENARIO

RECOVERY OF HOUSEHOLD CONSUMPTION AND RESILIENCE OF PRODUCTIVE INVESTMENT

Our central scenario for a gradual recovery in growth is based primarily on a balance between two powerful forces: the disinflationary process and the transmission of monetary tightening aimed at containing the past rise in inflation.

The disinflationary process, combined with the delayed catch-up in wages, would generate gains in purchasing power. In addition, the fall in inflation, once incorporated into consumer expectations, should lead to an improvement in consumer confidence and a reduction in precautionary savings. Growth in disposable income and a higher propensity to consume should support household consumption.

The rise in interest rates is slowly being passed on to the burden of servicing

household debt, which remains easily sustainable, helped by rising incomes and with no risk of crowding out consumption. The trade-off is already to the detriment of household investment, which is limited by worsening affordability conditions and by debt reduction forced in part by supply restrictions.

These developments justify the expected recovery in private consumption (1.1% in 2024 and 1.3% in 2025). The small and temporary increase in the unemployment rate (6.7% in 2024 and 6.6% in 2025, after 6.6% in 2023) will not derail this rebound based on an increase in the wage bill and its purchasing power. Households will also be able to draw on substantial accumulated savings. We expect the savings rate to fall from its current high level to its pre-pandemic average.

The deployment of monetary transmission will still be underway throughout 2024 (with a transmission delay of twelve to eighteen months after the last rate hike in September 2023), with its negative impact on residential investment and its drag on productive investment. The rate of growth in total investment will nevertheless be positive (0.9% in 2024 and 1.8% in 2025), but well below the 2014-2019 average. It is still benefiting from investment in the dual transition (digital and energy), which can be supported by State aid (in major European industrialisation projects) and the European recovery plan fund.

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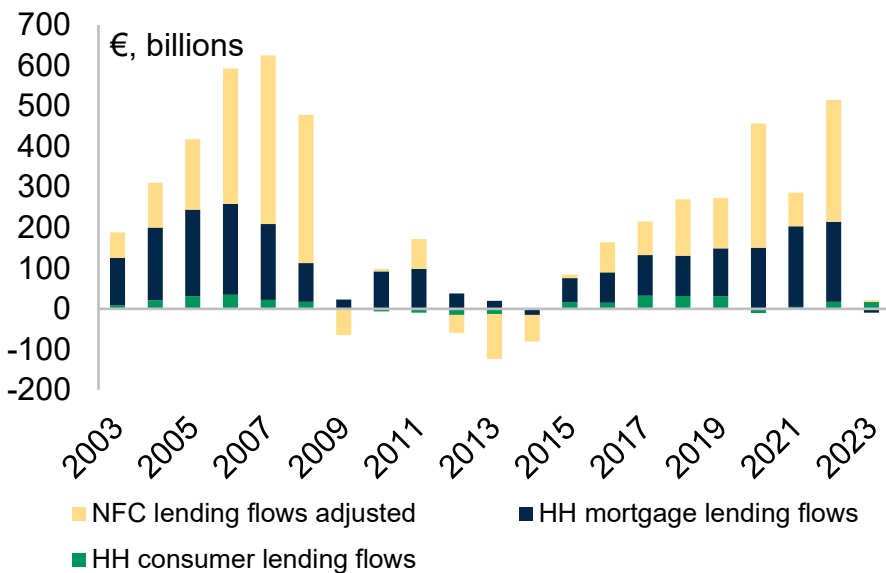
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FOCUS: THE IMPACT OF MONETARY TIGHTENING ON HOUSEHOLDS AND FIRMS

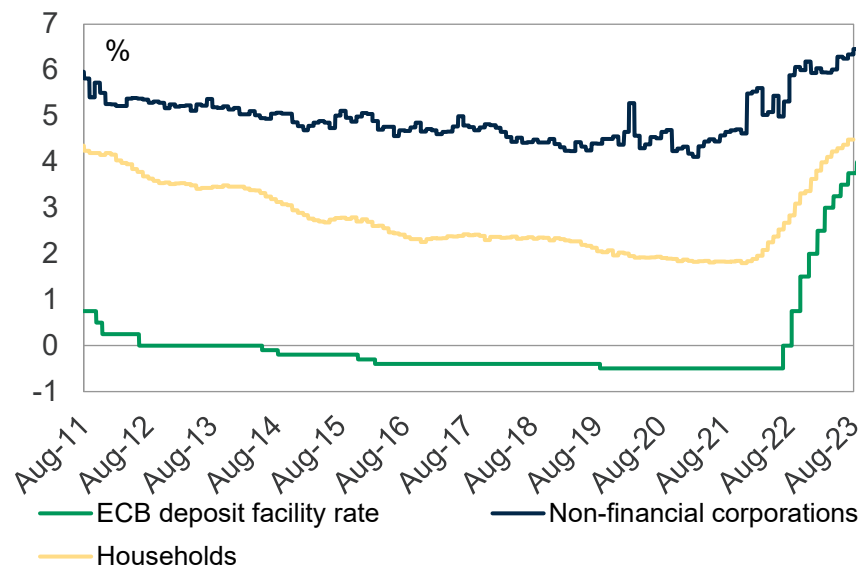
A POWERFUL BUT INCOMPLETE TRANSMISSION

Flow of credit to the private sector



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

Cost of financing private non-financial agents (composite)



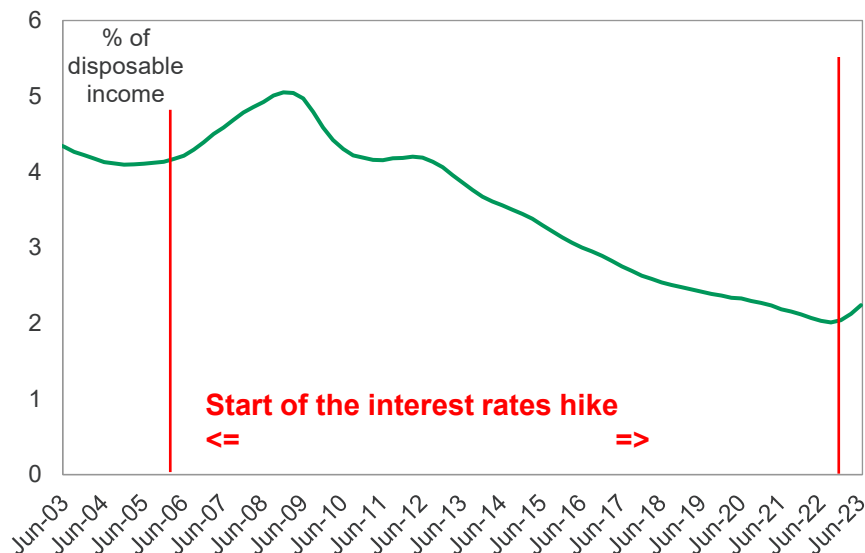
Sources: ECB, Crédit Agricole S.A./ECO

Private non-financial agents are in the process of reducing their debt. However, their financial situation remains favourable. The fall in physical investment is offsetting the reduction in their savings.

HOUSEHOLDS: STRENGTHS AND WEAKNESSES

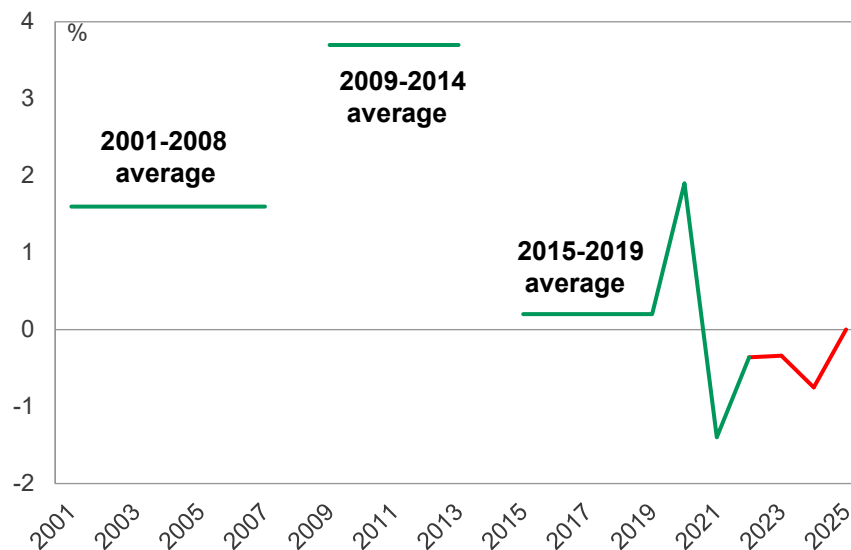
THE COST OF DEBT SERVICING IS RISING, BUT SO IS INCOME

Households: cost of debt servicing



Sources: European Commission, Crédit Agricole S.A./ECO

Gap between the average rate of debt servicing and growth in household disposable income: trends and forecasts



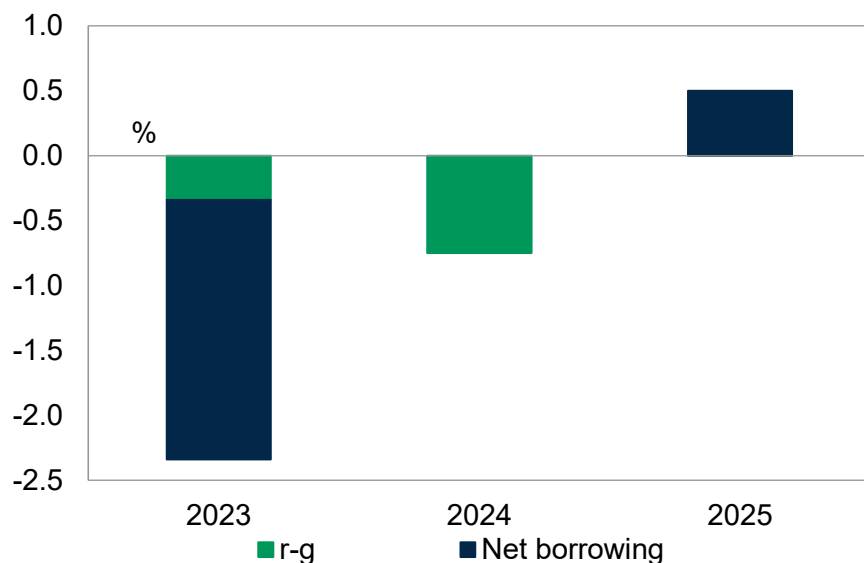
Sources: European Commission, Crédit Agricole S.A./ECO

The average rate on outstanding debt (r) is still lower than the growth rate of disposable income (g), limiting the risks of unsustainable debt. This spread ($r-g$) is very low compared to the past and is forecast to increase, but this increase is limited.

HOUSEHOLDS: STRENGTHS AND WEAKNESSES

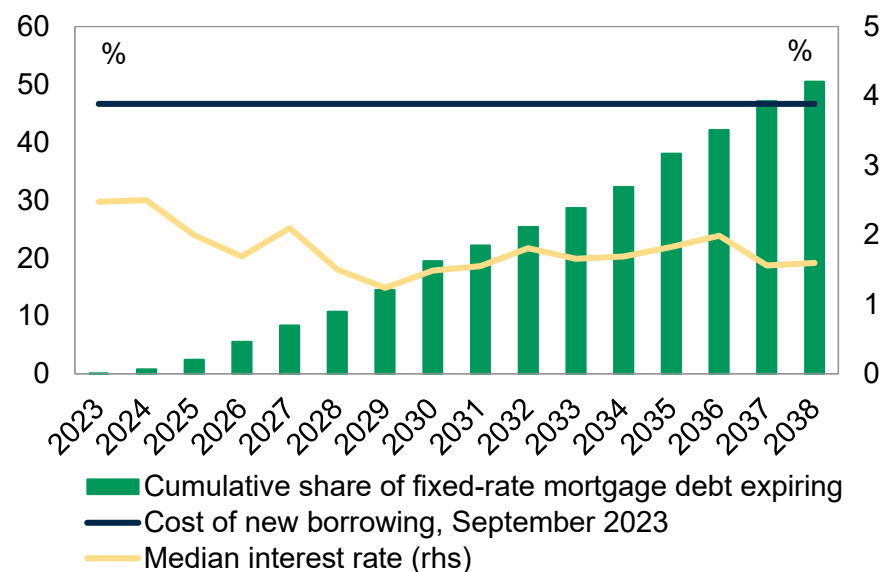
LIMITED COST OF DEBT, FINANCIAL STRENGTH, NO “SNOWBALL EFFECT” ON DEBT

Factors determining the growth in household debt



Sources: European Commission, Crédit Agricole S.A./ECO

The “debt wall” for households is a long way off



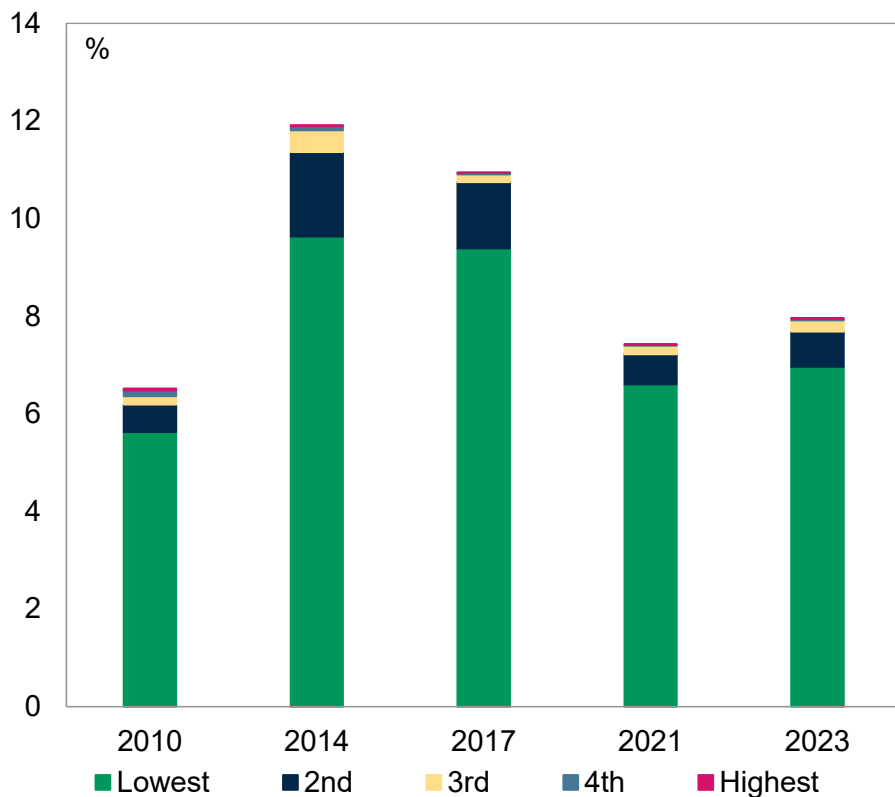
Sources: ECB, Crédit Agricole S.A./ECO

The very modest increase in the gap between the cost of servicing the debt and the rate of growth in disposable income will have little effect on the accumulation of household debt, and not before 2025. On the other hand, households still have a positive net lending capacity. These financial savings have also increased as a result of the decline in residential investment. It is helping to reduce household debt.

HOUSEHOLDS: STRENGTHS AND WEAKNESSES

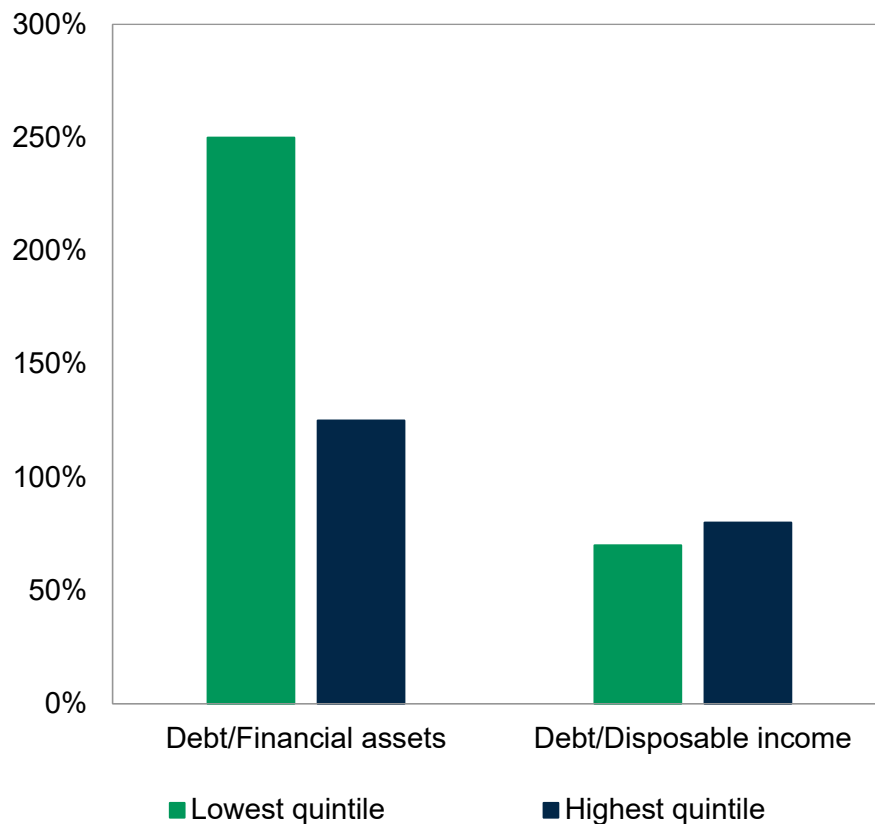
HETEROGENEITY AND VULNERABILITY OF THE LOWEST INCOME GROUPS

**Share of illiquid households
(by quintile of income distribution)**



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

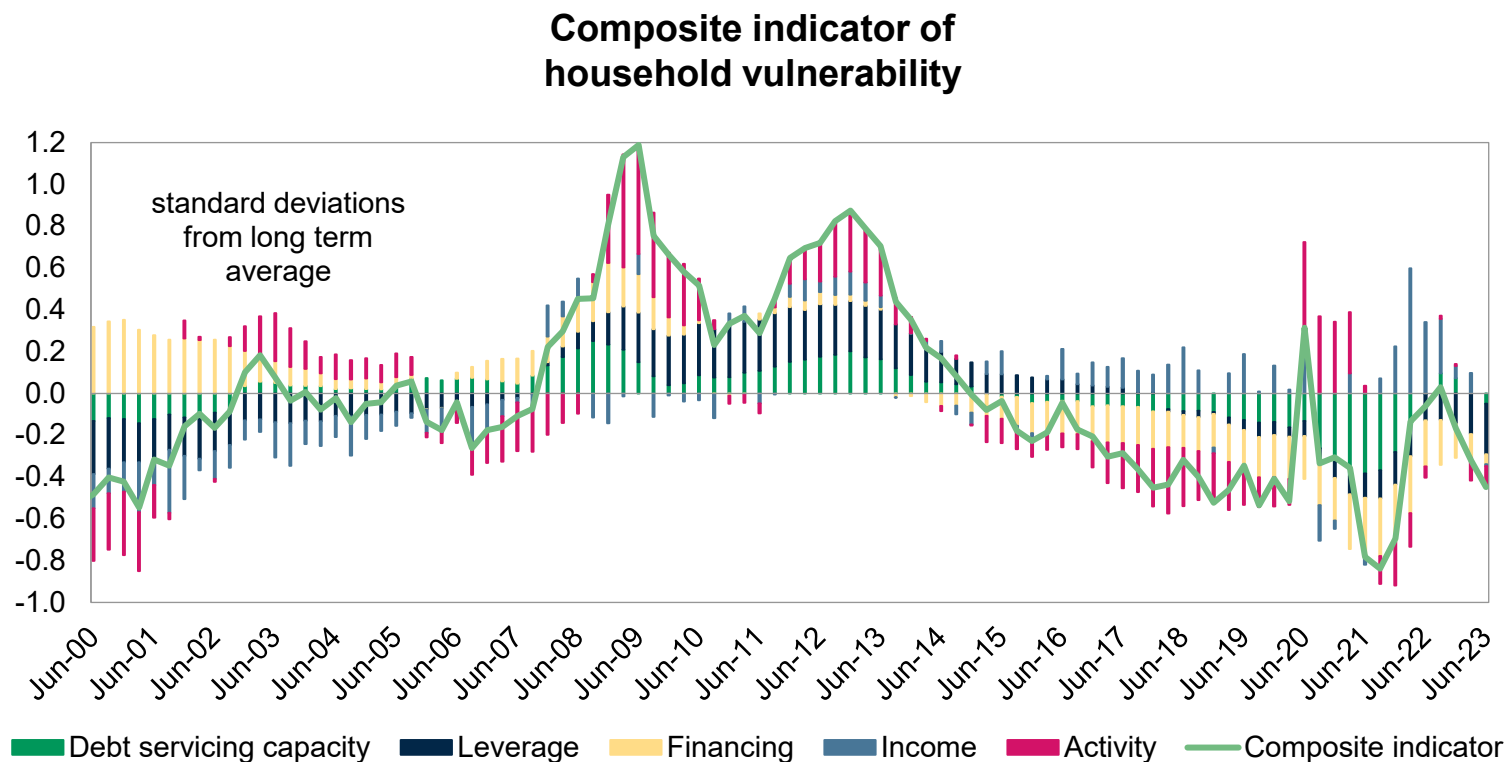
Uneven liquidity & debt servicing capacity



Sources: European Commission, Crédit Agricole S.A./ECO

HOUSEHOLDS: STRENGTHS AND WEAKNESSES

RISING REVENUES AND FALLING VULNERABILITY



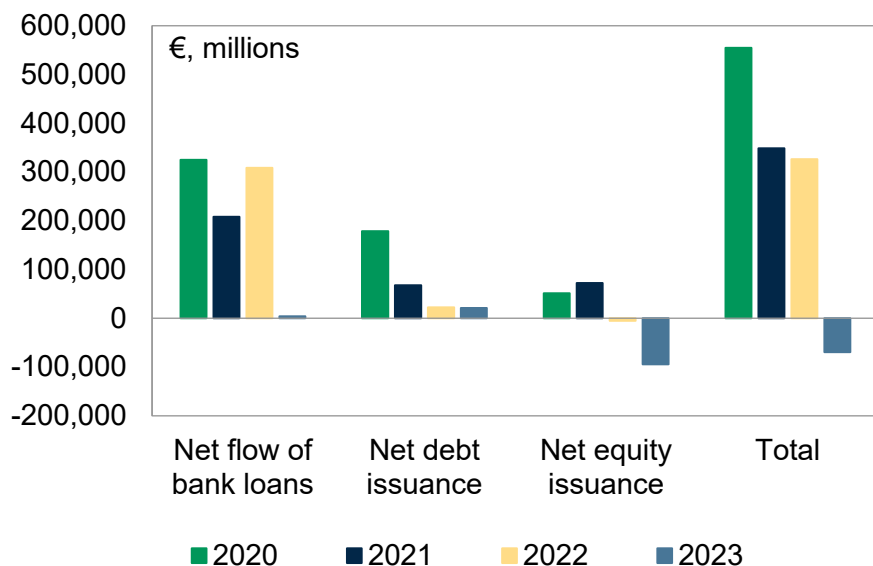
Sources: ECB, Crédit Agricole S.A./ECO

The fall in household savings has gone hand in hand with a slight improvement in confidence, boosting consumption. Income growth has been sustained and gains in purchasing power are set to continue, with wage growth expected to outpace inflation. Households' overall vulnerability is being reduced thanks to rising incomes, while the constraints associated with tighter financial conditions are weighing mainly on the affordability of housing investment and having little impact on the savings-consumption trade-off.

FIRMS: STRENGTHS AND WEAKNESSES

FALLING EXTERNAL FINANCING AND REFINANCING RISK

Financing of non-financial corporations by asset type (Q120-Q323)

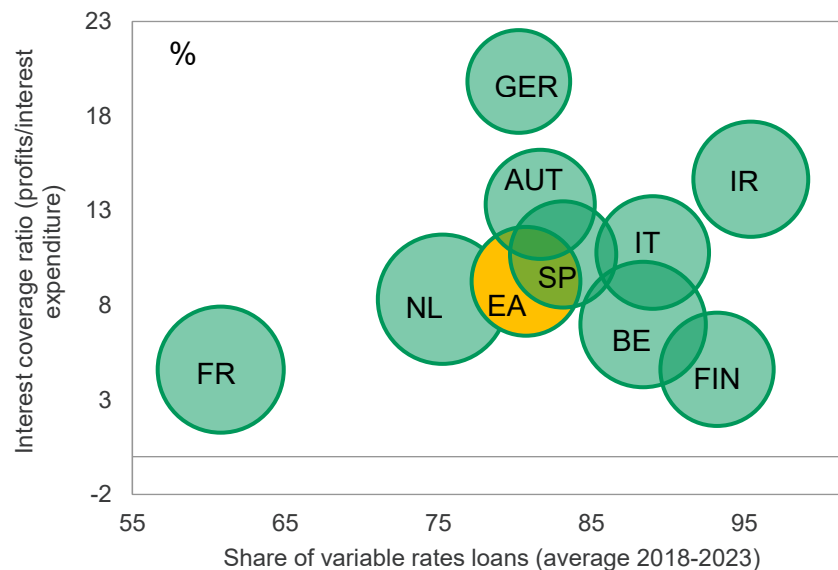


Sources: ECB, Crédit Agricole S.A./ECO

Businesses are seeing their profitability fall under the combined effect of rising wage bills and deteriorating productivity, even though input costs are falling.

Although profitability remains fairly high, investment is falling as external financing dries up and/or becomes more expensive. Countries with the highest proportion of variable-rate loans to businesses are more vulnerable to rising interest rates; but in several of these countries, the rate at which profits cover the cost of servicing debt is high.

Sensitivity and resilience to rising interest rates

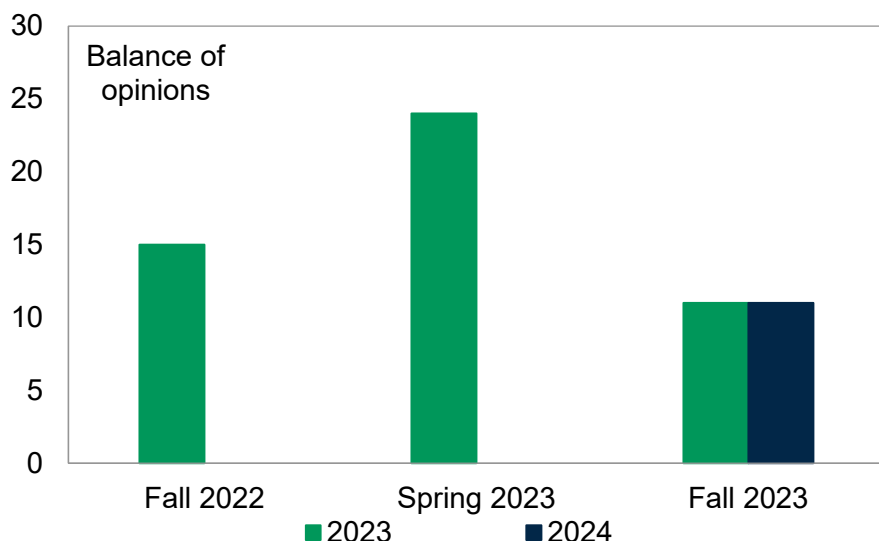


Sources: ECB, Crédit Agricole S.A./ECO

NON FINANCIAL CORPORATIONS: SURVEYS

LIMITED FINANCIAL CONSTRAINTS AND INCREASED INVESTMENT

Share of financially constrained companies

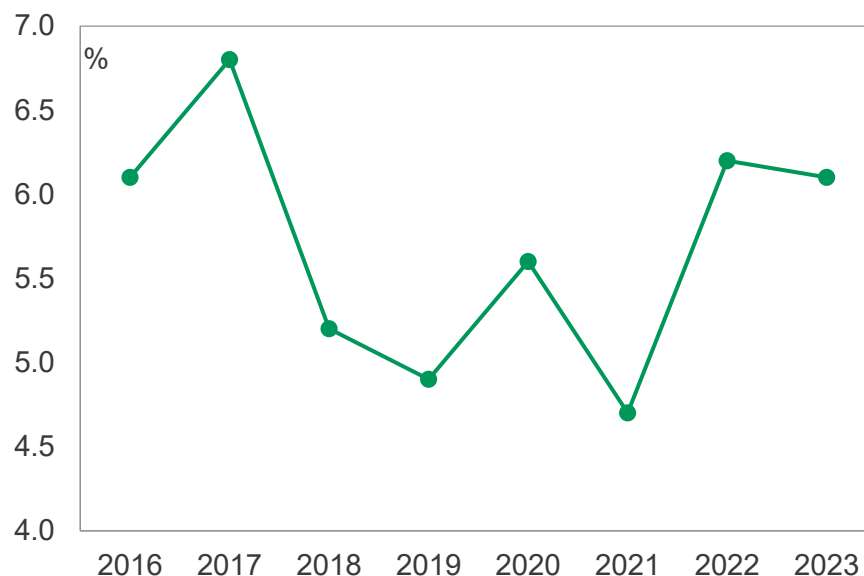


Sources: EIB Investment Survey 2023, Crédit Agricole S.A./ECO

Firms are still confident in their internal financing capacity (EIB survey) and continue to forecast an increase in investment in 2024 (European Commission survey).

These developments support our scenario of a soft landing for the Eurozone economy, based on a gradual recovery in activity, driven by household consumption and continued investment, particularly in manufacturing.

Percentage of companies expecting an increase in investment

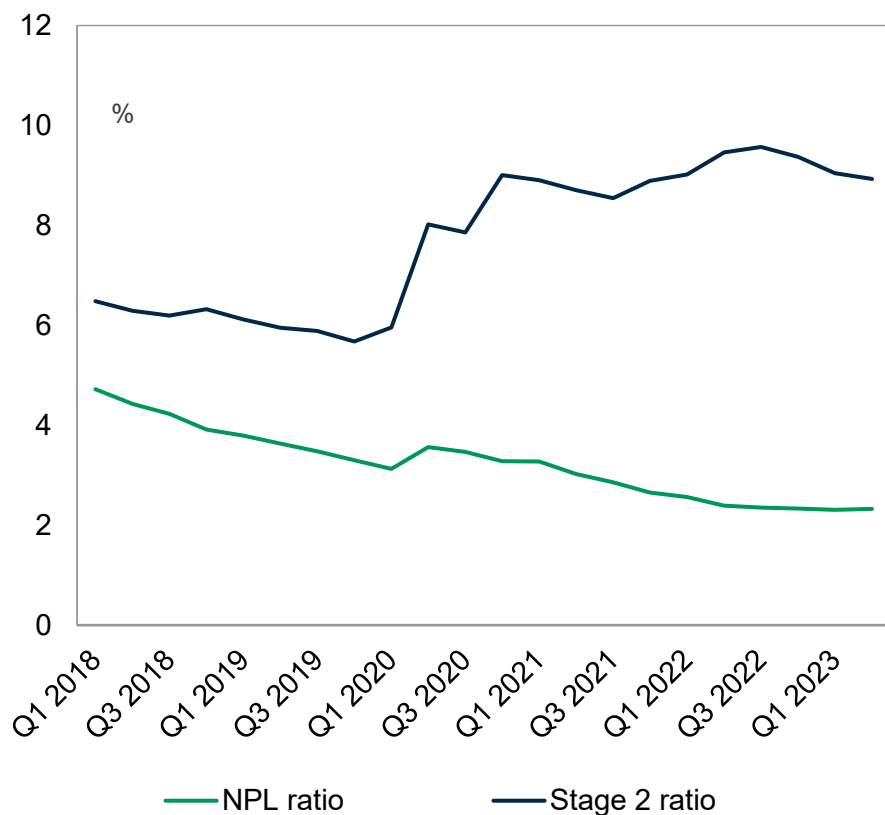


Sources: European Commission ESI, Crédit Agricole S.A./ECO

LATEST SIGNS POINT TO RESILIENCE

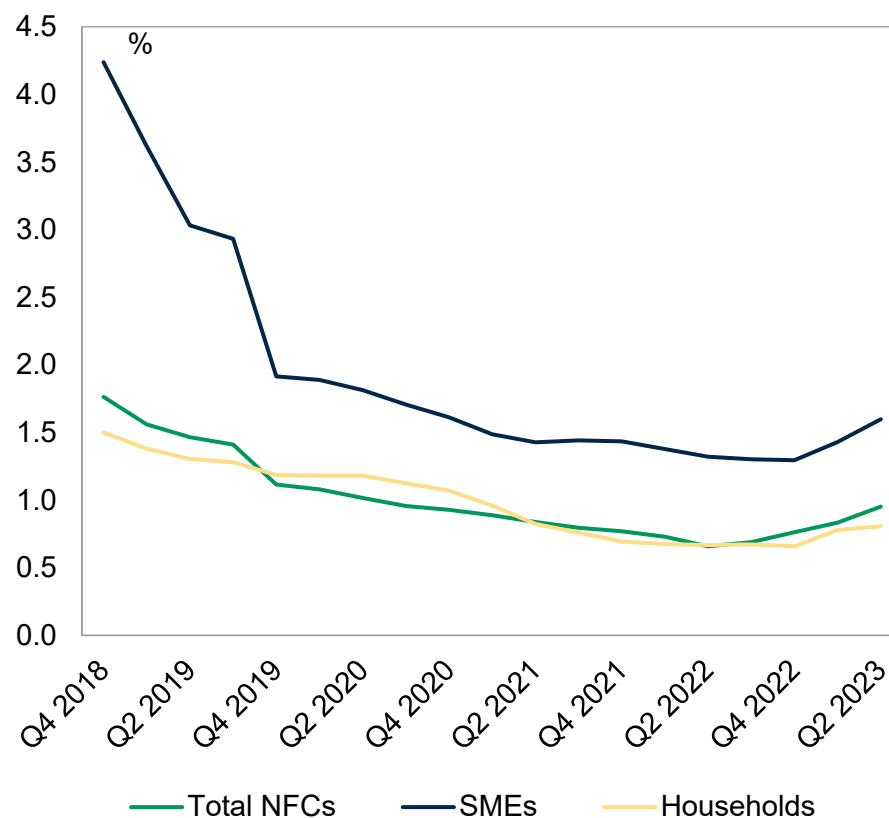
LIMITED DETERIORATION IN ASSET QUALITY

Non-performing loans



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

Loan default rate



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

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ECB: SATISFACTION WITH INFLATION AND THE TRANSMISSION OF TIGHTENING

CONTINUE TO MONITOR WAGES AND PROFITS BEFORE CUTTING RATES

The ECB is confident that inflation will return to its target. This is reflected in its sharply downwardly revised December inflation forecasts, which show a flatter trajectory than in previous forecasts. These forecasts constitute one of the three criteria on which the decision to change key interest rates will be based.

The other indicator on which the ECB will base its interest rate decision is core inflation (excluding volatile components), all of whose components are declining. The core inflation forecast has also been revised downwards in 2023 (from 5.1% to 5%) and 2024 (from 2.9% to 2.7%), but to a lesser extent than total inflation. By contrast, the core inflation forecast has been raised for 2025 (from 2.2% to 2.3%) and remains higher than total inflation in 2026 (2.1%). Core inflation will only reach 2.1% in Q4 2025. In fact, according to the ECB, wage growth (or, to be more precise, growth in compensation per employee) will remain

strong in 2025 (3.8% after 4.6% in 2024) and 2026 (3.3%).

The third decisive criterion for any decision on rates is the power of monetary policy transmission, with which the ECB seems fully satisfied. The slowdown in credit has now translated into a compression of aggregate demand, thus condemning the channel through which inflation is fed by economic agents' spending.

On the other hand, **the ECB has not completely ruled out the risk of second-round effects, and notes that the domestic component of inflation is falling only slightly. While effective wages per head in Q3 2023 have slowed (from 5.4% to 4.9%), this is not the case for other wage indicators. Moreover, while margins have been squeezed, the ECB is keen to continue monitoring unit profits to ensure that future wage increases are absorbed by margins and**

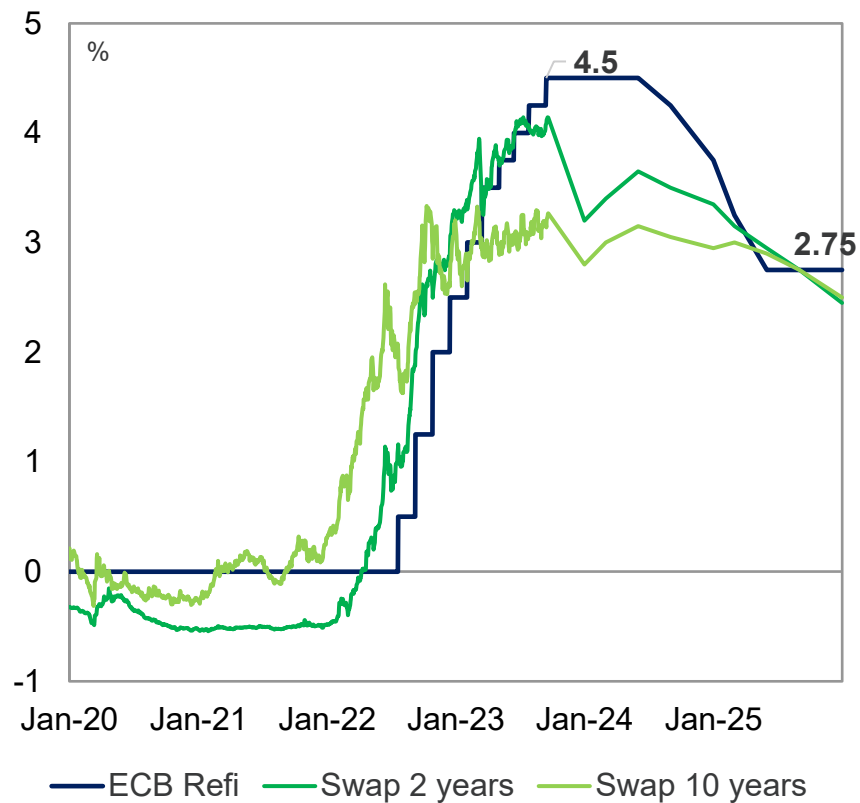
not passed on to selling prices. Confirmation of the slowdown in wages and profits based on national accounts data for the last quarter of 2023 and the first quarter of 2024 will therefore be necessary for the ECB before any decision to cut key rates. All the more so as 50% of wages covered by the ECB's wage tracker will be subject to renegotiation in the first half of 2024, and companies will also be readjusting their price lists at the start of the year.

These new ECB inflation forecasts are consistent with **our schedule of a first rate cut of 25 basis points in September. Two more of the same magnitude are expected to follow by the end of 2024 and one at each meeting, representing 50 basis points per quarter in the first half of 2025. They would raise the refinancing rate to 2.75%, the new neutral or equilibrium rate, consistent with inflation at target.** The criteria for a new normality would be met.

ECB: A LITTLE MORE PATIENCE

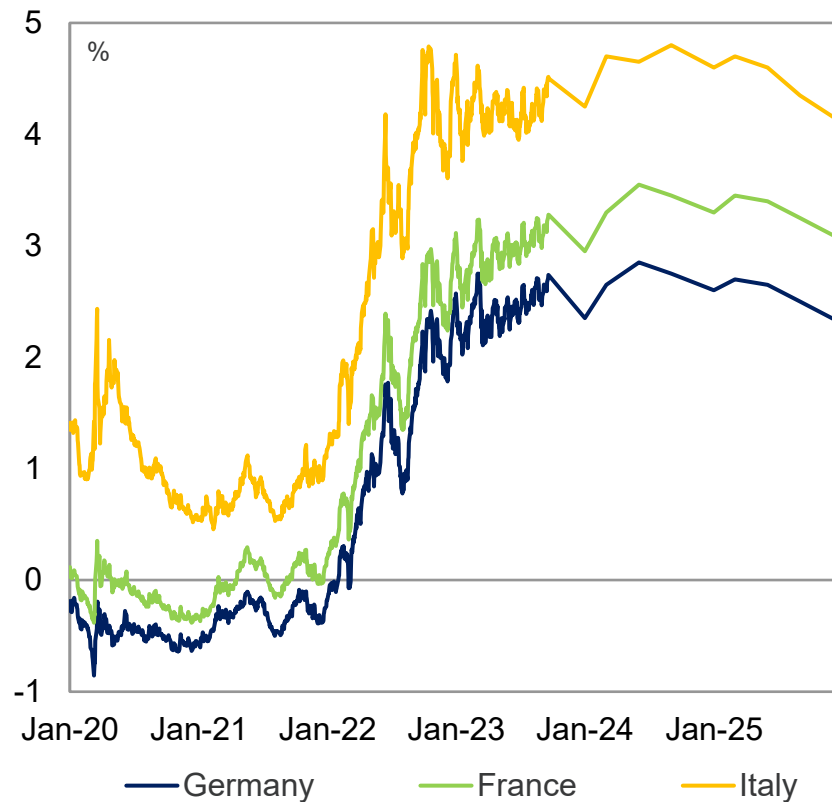
TO AVOID ANY RISK

ECB: still pending



Sources: Bloomberg, CACIB, Crédit Agricole SA/ECO

Sovereign rates (10years) :
limited downside potential



Sources: Bloomberg, CACIB, Crédit Agricole SA/ECO

ECB: A FURTHER STEP TOWARDS DOUBLE NORMALISATION

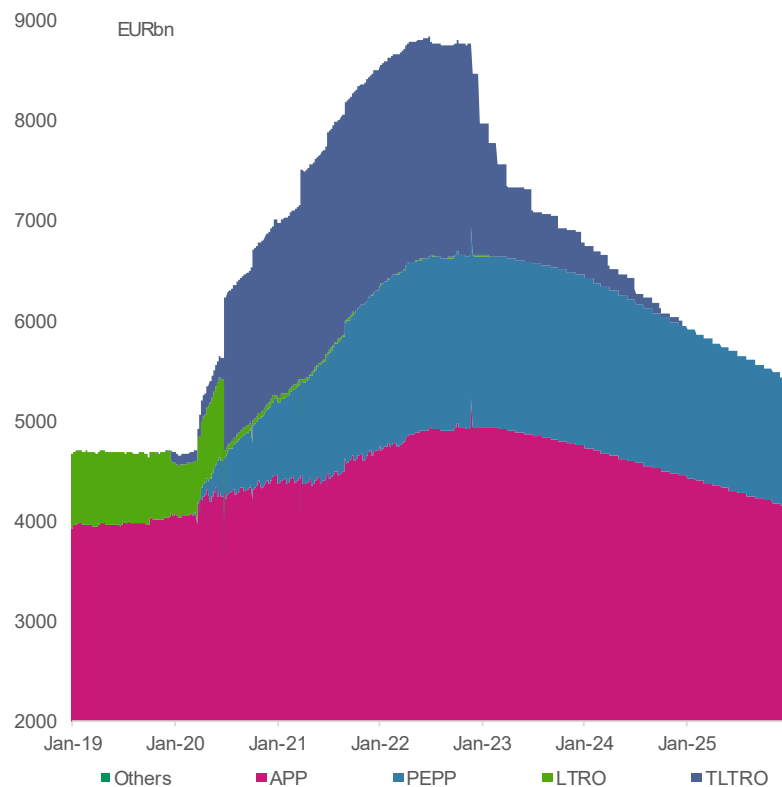
RATES AND BALANCE SHEET IN OPPOSITE DIRECTIONS

The “new normal”, with a refinancing rate of 2.75% and a deposit rate of 2.5% with a tighter corridor, is not the old normal, the one before the great economic and financial crisis.

The ECB is certainly committed to normalising the size of its balance sheet: it will continue to reinvest all maturing securities until the end of June 2024. It will then reduce the PEPP portfolio by an average of €7.5 billion per month in the second half of 2024 and end reinvestments at the end of 2024.

However, it will remain oversized compared with 2008. The new optimal size of its balance sheet will be discussed by the ECB in 2024 prior to the conclusions of its operational strategy review. It is nonetheless clear that the autonomous factors of excess liquidity and reserve requirements are still three times what they were before the crisis, and that the banks' needs for regulatory purposes justify an ECB balance sheet that is structurally larger than before.

Passive reduction in the size of the balance sheet



Sources: ECB, Bloomberg, Crédit Agricole CIB

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FISCAL POLICY: BACK TO THE PAST

THE COMMISSION STEPS UP THE PRESSURE ON MEMBER STATES

After three years of strong positive stimulus to the economy (4 cumulative GDP points between 2020 and 2022), the fiscal stance would become restrictive in 2023 and 2024, bringing the Eurozone deficit to 3.4% in 2023, 3.1% in 2024 and 2.8% in 2025. This moderation would make it easier to keep inflation under control by compressing demand, and would not hinder monetary tightening by the European Central Bank.

The measures designed to deal with Covid will have been entirely abolished in 2023, and those linked to rising energy costs in 2024. The reduction in primary expenditure and investment subsidies (notably the Superbonus in Italy and the recapitalisation of Uniper in Germany in 2023) would more than offset the increase in public investment financed by national budgets, guaranteeing a negative impulse. National investment would be preserved and investment financed by European funds increased thanks to the peak in NGEU payments in 2024 and 2025.

Hitherto favourable conditions for debt sustainability are deteriorating. Inflation, which had stimulated nominal growth in 2022, but also in 2023, fades, reducing the positive effect on the denominator of the debt/GDP ratio. While monetary tightening has had only a marginal impact on the cost of debt for the time being, due to long maturities, its effect will gradually be incorporated into the average cost of outstanding debt. As a result, the gap between this rate and the nominal GDP growth rate will widen: stabilising or even reducing debt/GDP ratios will require ever smaller primary deficits (or, for some countries, ever larger surpluses).

Choices will have to be made, as the post-Covid period has been characterised by structural spending increases and permanent tax cuts. This phase of transition to a new equilibrium of inflation and lower interest rates will therefore constrain government action. Until 2026, however, the capacity for investment spending made possible by European funds will continue to limit the restrictive stance of fiscal policy, offsetting the effort that will have to be made by national budgets.

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