



EUROZONE 2022-2023 SCENARIO

RESILIENCE AGAINST ENDEMIC COVID-19 AND THE SUPPLY SHOCK

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IN YOUR INTEREST**



GROUP ECONOMIC RESEARCH

CONTENTS

1 | SUMMARY

2 RECENT ECONOMIC TRENDS

3 SCENARIO

4 FOCUS: THE LINK BETWEEN INFLATION AND EMPLOYMENT

5 POLICY MIX

SUMMARY

RESILIENCE AGAINST ENDEMIC COVID-19 AND THE SUPPLY SHOCK

The eurozone is facing an exogenous inflationary shock against a backdrop where the negative output gap still has not been closed. Indeed, at just -0.3% away, the zone has virtually returned to its pre-crisis GDP level, but will not reach the level it projected before the pandemic until mid-2022. Despite the strength of the rebound, aggregate demand is still weak, which is consistent with the modest uptick in wages and the more persistent, albeit temporary, rise in inflation.

The main risk of rising inflation is its impact on growth, as inflation erodes purchasing power, rather than on expectations that could fuel a price-wage spiral. Monetary and fiscal policy authorities should take this risk into consideration and maintain a cautious approach, which justifies our scenario of an ongoing accommodating policy mix.

The test of resilience in this strong recovery phase is that supply-side weakness (logistical bottlenecks, tight supply chains, input and labour shortages) is expected to be more persistent and make economies more vulnerable to the slightest shock, although signs of easing constraints are visible in the state of inventories and backlogs.

The damage inflicted on the eurozone economy by the pandemic appears to be less severe than initially expected, which corroborates our outlined optimistic scenario of expansion transitioning from unusual to more normal but steady levels. The impact of the

latest wave of Covid remains limited for the entire zone, thanks to its high rate of vaccine coverage. **We are forecasting GDP growth of 5.2% in 2021, 4.3% in 2022 and 2.5% in 2023.**

Despite the strength of the rebound in Q2 2021 (+2.2%), growth did not lose any strength in Q3 (+2.2%) leaving a very large overhang (5.1%) for average annual GDP growth in 2021.

Although private consumption increased further (+4.1%, after 3.9%), this pace is not enough to close the gap with the pre-crisis level, which remains at 2.4%.

Growth in productive investment excluding transport equipment remained positive, returning to its usual pace, while the build-up of transport equipment declined further (-8.6%). The dip in construction investment is due to drops in two components, housing and other construction, after several quarters of very solid growth.

The slowdown in activity that occurred starting in Q4 2021 (0.5%) originated in the normalisation of demand, but was accentuated by growth downgrades in Germany, the Netherlands and Austria associated with the fifth wave of the pandemic. Growth should then return at a quicker pace than its pre-crisis level.

The risk of the private sector becoming insolvent due to the increased debt taken on in the wake of the pandemic is lower than initially

expected. Corporate bankruptcies may still rise but not to the levels feared during the lockdown. Existing corporate balance sheet support and favourable financing terms will underpin investment (+4.4% in 2022 and 2023, after 3.5% in 2021), strengthened by needs linked to the digital and energy transitions.

Eurozone households are gradually shifting their excess savings into investment in illiquid assets, thereby supporting housing investment in addition to consumption. Nonetheless, low-income households still remain highly dependent on public support and have already begun to dip into surplus savings accumulated during the crisis. Employment income will increase at the same rate as inflation, thereby stabilising purchasing power. Positive wealth effects and the normalisation of savings behaviour will support consumption (5.9% in 2022 and 2.2% in 2023 after 3.5% in 2021). The potential erosion of accumulated surplus savings is an upside risk in our scenario.

SUMMARY

STRONG REBOUND AND MODERATION OF GROWTH AT A STILL HIGH PACE

Growth forecasts

Quarterly rate
(QoQ, %)

Annual rate
(YoY, %)

EMU	2021				2022				2023				2020	2021	2022	2023
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
GDP	-0,2	2,2	2,2	0,5	0,9	1,0	0,9	0,8	0,5	0,5	0,4	0,4	-6,5	5,2	4,3	2,5
Households consumption	-2,3	3,9	4,1	0,6	1,1	1,0	0,8	0,6	0,5	0,4	0,3	0,3	-8,0	3,5	5,9	2,2
Public consumption	-0,6	2,1	0,3	0,3	0,2	0,2	0,2	0,2	0,2	0,2	0,2	0,2	1,3	3,8	1,4	0,8
Total GFCF	0,0	1,3	-0,9	1,2	1,5	1,5	1,3	1,3	1,0	1,0	0,9	0,9	-7,3	3,6	4,4	4,4
G&S exports	1,2	2,4	1,2	1,2	1,6	1,5	1,4	1,3	0,9	1,0	1,0	0,9	-9,4	9,6	5,9	4,5
G&S imports	1,0	2,9	0,7	1,4	1,7	1,4	1,4	1,3	1,0	1,0	1,0	1,0	-9,3	7,1	6,0	4,6
Inventory changes (% of GDP)	0,8	0,4	0,3	0,2	0,2	0,2	0,3	0,3	0,3	0,4	0,3	0,4	0,2	0,4	0,3	0,4
<i>Contributions to GDP growth</i>																
Domestic demand excluding inventories	-1,3	2,7	2,0	0,6	0,9	0,9	0,7	0,6	0,5	0,5	0,4	0,4	-5,6	3,5	4,3	2,2
Inventories	1,0	-0,4	-0,1	-0,1	0,0	0,0	0,0	0,1	0,0	0,0	0,0	0,0	-0,5	0,3	-0,2	0,1
Net exports	0,1	-0,1	0,3	-0,1	0,0	0,1	0,1	0,1	0,0	0,0	0,0	0,0	-0,4	1,4	0,2	0,1

Quarterly rate
(QoQ, %)

Annual rate
(YoY, %)

Eurozone	2021				2022				2023				2020	2021	2022	2023
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Eurozone	-0,2	2,2	2,2	0,5	0,9	1,0	0,9	0,8	0,5	0,5	0,4	0,4	-6,5	5,2	4,3	2,5
Germany	-1,9	2,0	1,7	0,2	1,3	1,2	0,7	0,6	0,3	0,3	0,3	0,3	-4,9	2,7	4,2	1,9
France	0,1	1,3	3,0	0,5	0,5	0,6	0,8	0,8	0,7	0,4	0,4	0,4	-8,0	6,8	4,4	2,5
Italy	0,3	2,7	2,6	0,4	0,5	1,0	0,9	0,8	0,3	0,6	0,4	0,5	-9,0	6,3	4,2	2,4
Spain	-0,6	1,1	2,0	1,2	1,1	1,1	1,5	1,2	1,0	1,1	0,6	0,6	-10,8	4,3	5,3	4,3
Netherlands	-0,8	3,8	1,9	0,5	0,9	0,8	0,6	0,5	0,4	0,4	0,4	0,4	-3,8	4,6	4,2	1,9
Belgium	1,2	1,7	1,8	0,8	0,6	0,5	0,4	0,4	0,4	0,4	0,4	0,4	-5,7	6,1	3,2	1,5
Ireland	8,7	6,3	3,6	1,6	0,0	2,0	0,9	0,9	1,0	1,0	1,0	1,1	5,8	16,9	6,8	4,2
Portugal	-3,3	4,5	2,8	1,9	0,7	0,7	0,5	0,5	0,5	0,5	0,5	0,4	-8,4	4,7	5,6	2,1
Greece	4,5	3,4	-1,8	-1,4	2,7	2,3	2,2	1,5	0,5	0,4	0,4	0,7	-7,8	6,7	4,7	4,0
Finland	0,1	2,2	0,9	0,3	0,5	0,5	0,5	0,5	0,5	0,5	0,5	0,5	-2,9	3,4	2,5	2,1
Luxembourg	3,7	0,0	1,2	0,7	0,6	1,0	0,6	0,6	0,6	0,6	0,6	0,6	-1,8	7,3	2,9	2,4
Austria	-0,4	4,2	3,8	-0,2	0,7	1,1	0,8	0,6	0,4	0,4	0,3	0,3	-6,8	5,2	4,9	2,0
Slovenia	1,5	2,0	0,4	1,6	1,1	1,0	0,9	0,3	1,0	1,0	1,1	1,1	-4,8	6,7	4,3	3,6
Malta	1,9	-0,5	1,0	0,3	1,7	2,8	1,5	1,4	1,1	0,8	0,8	0,8	-8,2	5,1	5,6	4,9

CONTENTS

1 SUMMARY

2 RECENT ECONOMIC TRENDS

3 SCENARIO

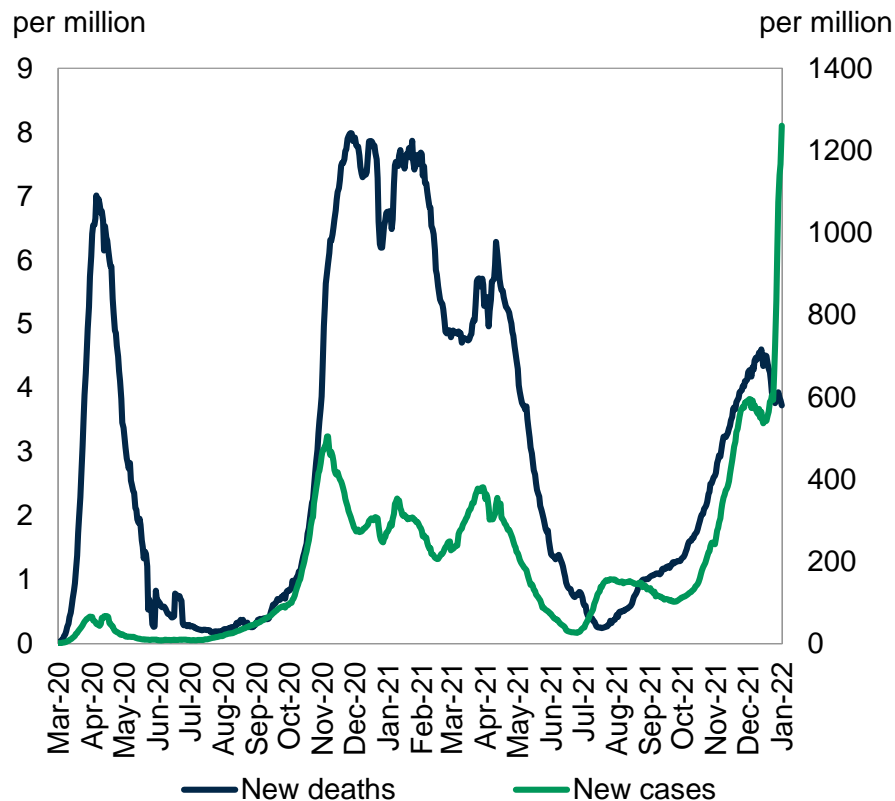
4 FOCUS: THE LINK BETWEEN INFLATION AND EMPLOYMENT

5 POLICY MIX

HOW THE SCENARIO HOLDS UP AGAINST OMICRON

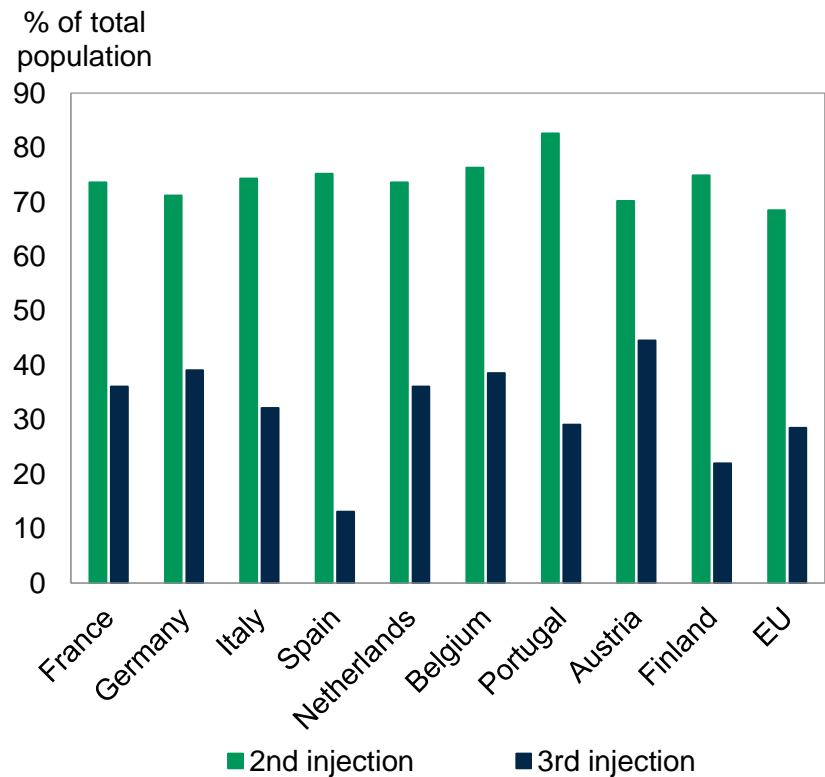
A LESS LETHAL VARIANT AND HIGH VACCINATION RATES ARE LIMITING THE IMPACT

Omicron: higher transmission, lower mortality



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

Vaccination progress

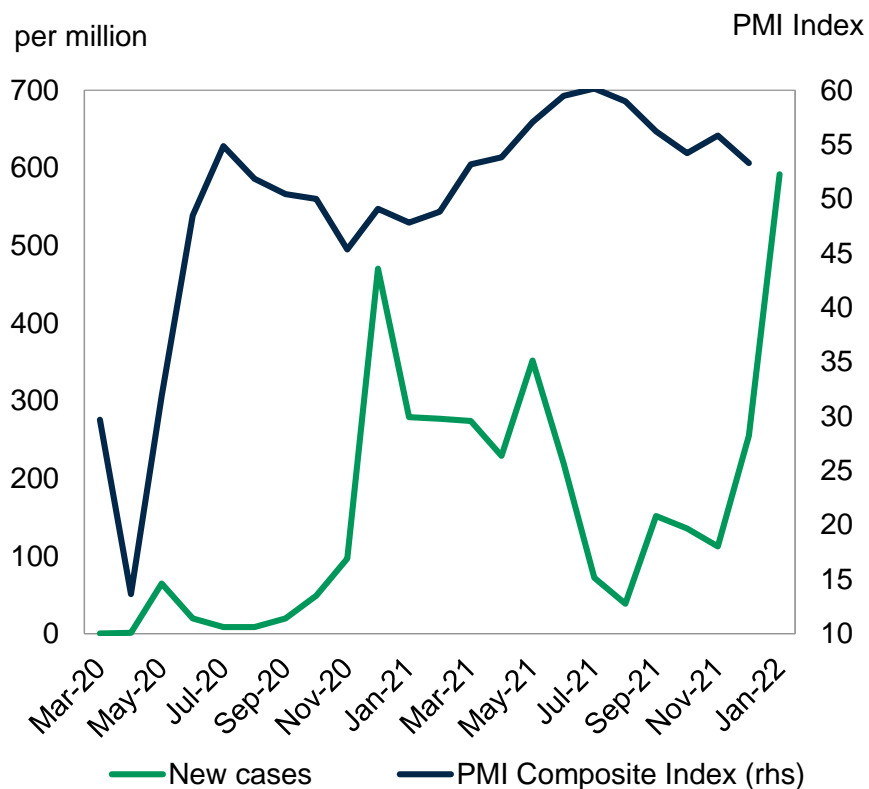


Sources: ECDPC, Crédit Agricole S.A./ECO

HOW THE SCENARIO HOLDS UP AGAINST OMICRON

A LESS LETHAL VARIANT AND HIGH VACCINATION RATES ARE LIMITING THE IMPACT

Infections and activity



Sources: WHO, Markit, Crédit Agricole S.A./ECO

The link between the number of infections and activity is weakened.

The impact on demand is mainly limited to services that have not suffered significant disruptions in behaviour.

There is unlikely to be an impact on supply.

Risks:

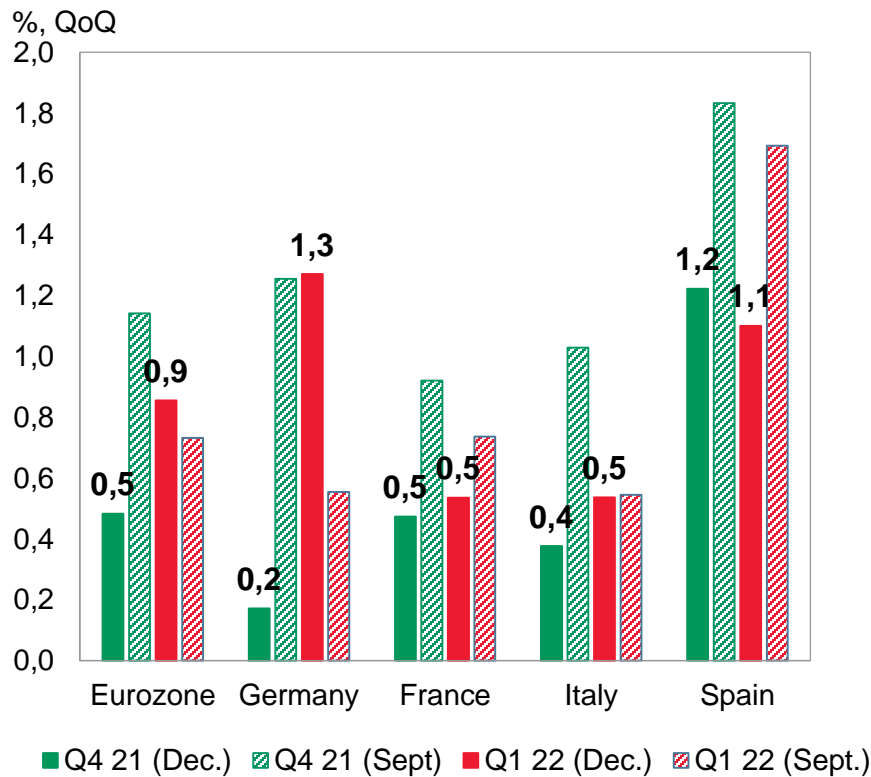
Cautionary behaviours in high-contact activities.

The high number of cases introduces a risk of **labour supply dislocation** if employees have to isolate.

HOW THE SCENARIO HOLDS UP AGAINST OMICRON

A DOWNSIDE RISK FOR THE WINTER

Forecasts downgraded



Forecasts have already been downgraded, especially in Austria, the Netherlands (in lockdown), Germany (in partial lockdown) and Italy.

Downside risk elsewhere and in Q1 2022.

Upside risk in Q2 2022.

Source: Crédit Agricole SA/ECO

CONTENTS

1 SUMMARY

2 RECENT ECONOMIC TRENDS

3 | SCENARIO

4 FOCUS: THE LINK BETWEEN INFLATION AND EMPLOYMENT

5 POLICY MIX

THEMES OF THE SCENARIO

A NOT QUITE COMPLETE BUT MODERATELY REFLATIONARY RECOVERY

A scenario developed in early December that holds up despite the Omicron wave

A brake on activity but without major disruptions in behaviour and with more synchronisation between countries

Downside risk in Q4 2021 and Q1 2022 but upside in Q2 2022

Normalisation of demand and supply = decline in inflation

Gradual loss of strength in consumption offset by easing of supply constraints, recovery of production and the inventory cycle

A recovery that will not be complete until the end of 2022: pre-crisis level of activity already achieved but pre-crisis forecasts still to be reached

Exogenous inflationary shock with output gap still to be closed = low aggregate demand and purchasing power risk greater than inflationary spiral risk

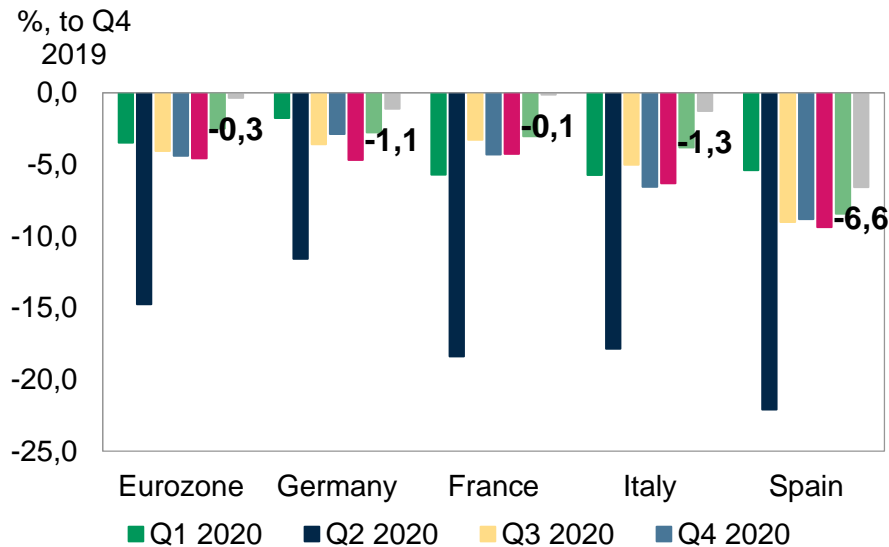
A recovery that nevertheless allows for a recovery in core inflation

Very gradual and careful withdrawal of monetary and fiscal accommodation

THEMES OF THE SCENARIO

A NOT QUITE COMPLETE BUT MODERATELY REFLATIONARY RECOVERY

GDP: gap to pre-crisis level

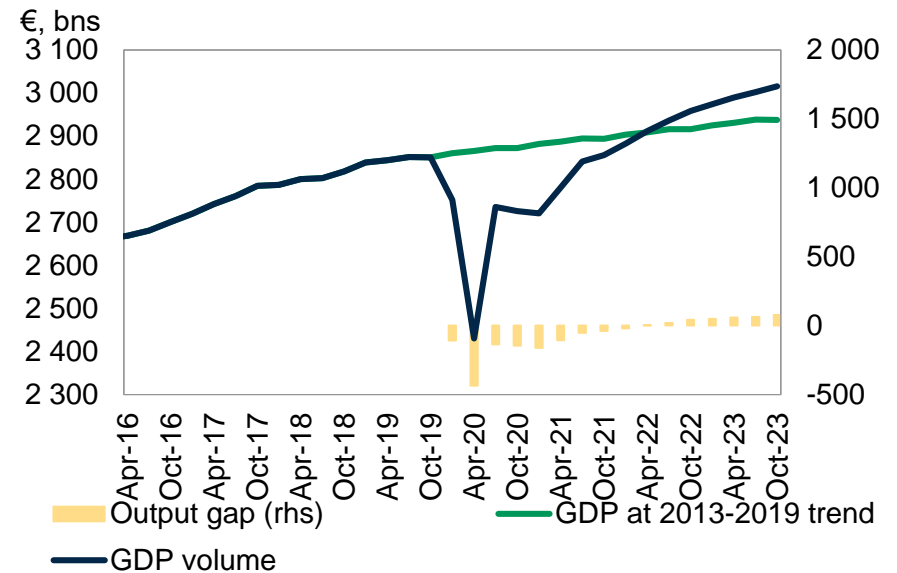


Sources: Eurostat, Crédit Agricole S.A./ECO

At just -0.3% away, the zone has virtually returned to its pre-crisis GDP level, but has not caught up completely everywhere.

It caught up in France in Q3 2021, but is further behind in Germany and Italy and still a long way from closing the gap to its pre-crisis level in Spain.

GDP trajectory before and after the Covid-19 crisis



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

Where it will not reach the level it projected before the pandemic until mid-2022.

Thereafter, growth will continue at a more moderate pace, but still above the potential and pre-crisis projected pace.

After the rebound and catch-up, stimulus packages will take over to support investment and growth.

HOUSEHOLDS: NORMALISATION OF INCOME SOURCES

FACED WITH STAGNATING PURCHASING POWER IN 2022, CONSUMPTION GROWTH IS CONTINGENT ON A FURTHER FALL IN THE SAVINGS RATE

Consumption's catch-up to pre-pandemic levels is well underway but incomplete as of Q3 2021 (-2.4%).

Household spending increased by 4.1% in the quarter, up from 3.9% in Q2. Q3 marked a further decline in the savings rate in the eurozone. At 15%, it has reached its lowest level since the outbreak of the Covid crisis, but it remains higher than any level experienced before the crisis. **As such, the excess savings accumulated during the crisis have been greatly reduced, but they are still positive in the eurozone and its main economies.** This surplus is smaller in Germany than in France, Italy and Spain. It increased further in Spain in Q3, unlike in the other major countries.

The fall in the savings rate accompanied sustained growth in consumption and offset the weaker growth of nominal disposable income (0.8% for the quarter after 1.4% in Q2) and above all the stability of real disposable income. Disposable income rose thanks to a strong increase in

employment income driven by the pick-up in salaried employment (1%) and wages per capita (+2.3% over the quarter). Self-employed income also saw a solid increase, while income support for households from the government declined and taxes dragged down disposable income growth for the second consecutive quarter after five quarters of positive contributions.

As such, income sources are in the process of normalising, with employment income making a greater contribution thanks to activity behaviour that is gradually returning to its pre-pandemic form. Households continued to invest in housing, albeit at a slower pace, but their investment rate continued to rise. Their financial investment decreased, especially in liquid assets, but their share of income continued to rise. Bank debt has continued to increase more quickly, but the debt in GDP points is falling. A rebound in financial wealth, driven by valuation gains, and in real estate wealth is pushing up household net wealth.

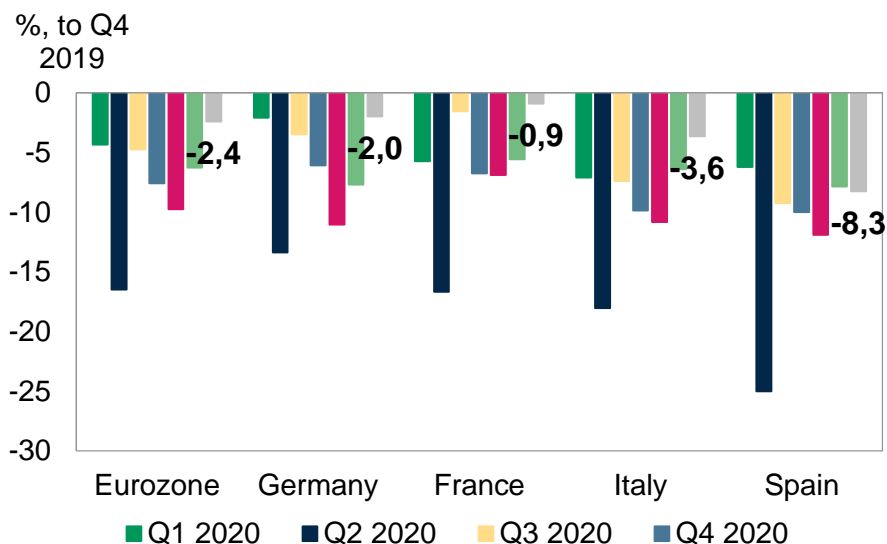
Eurozone households are gradually shifting their excess savings to consumption, but also into investment in illiquid assets and housing. Nonetheless, low-income households still remain highly dependent on public support and have already begun to dip into surplus savings accumulated during the crisis.

Employment income growth will moderate in the coming quarters, once the catch-up process in employment and hours worked is completed. **Disposable income will return to a similar growth rate to prices, which will stabilise purchasing power in 2022. Positive wealth effects and the normalisation of savings behaviour will support consumption (5.9% in 2022 and 2.2% in 2023 after 3.5% in 2021).**

CONSUMPTION: STILL CATCHING UP

NORMALISATION OF INCOME SOURCES AND SPENDING ON SERVICES

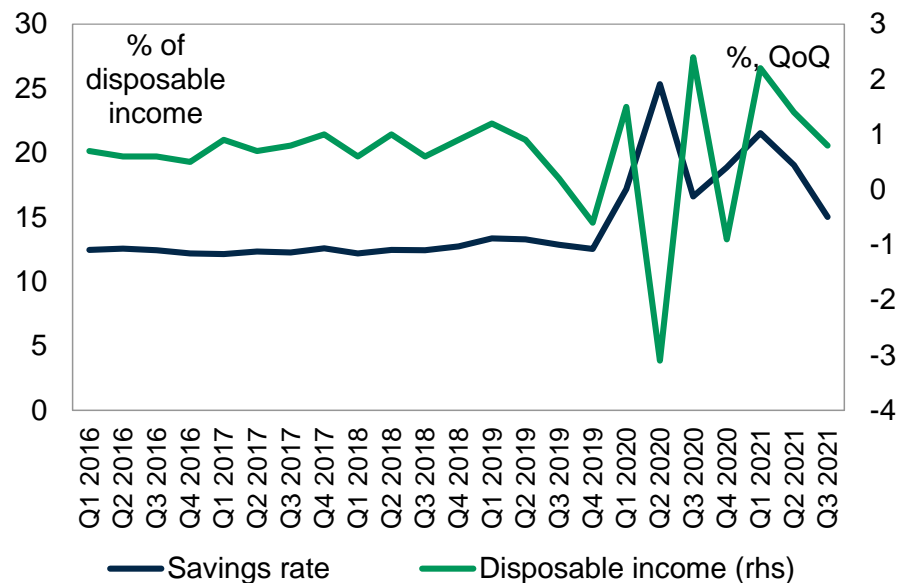
**Household consumption :
gap to pre-crisis level**



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

Consumption's catch-up to pre-pandemic levels is well underway but incomplete as of Q3 2021 (-2.4%). Household spending increased by 4.1% in the quarter, up from 3.9% in Q2, driven by a recovery in the consumption of services. This increase was uneven between countries: 6.2% in Germany and 5% in France, it was more modest in Italy (3%) and especially in Spain (1%). Thus, consumption has almost returned to its pre-crisis level in France. It is a little further behind in Germany and Italy, but still has to close a very large gap in Spain.

Strong income growth and falling savings rate



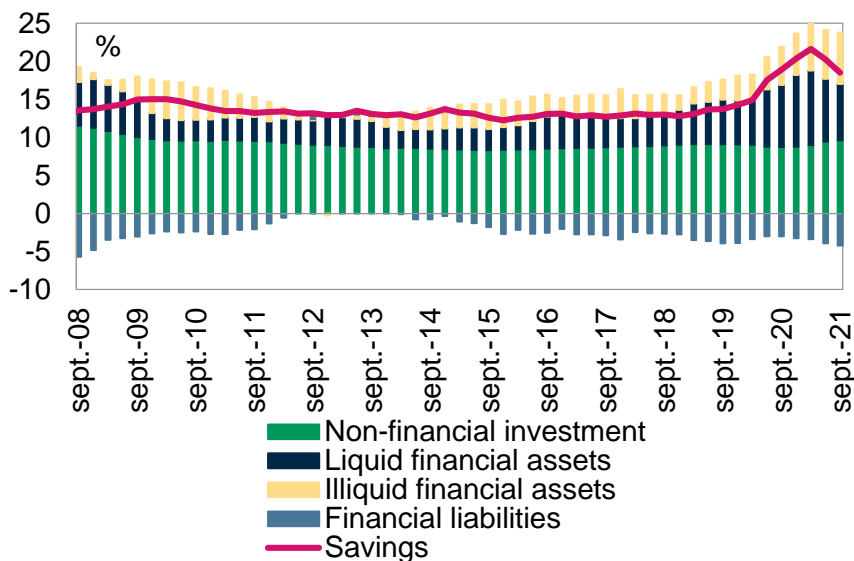
Sources: Eurostat, Crédit Agricole S.A./ECO

After the very sharp rebound in disposable income in Q2 2021 linked to the strong recovery in employment income with the reopening of business, consumption growth remained solid, albeit slower, in Q3. It was supported by the strong rebound in total payroll, the sharp growth in EBITDA and mixed self-employed income. However, higher taxes and lower benefits have dampened the rebound. This is the result of the return to normal activity and activity behaviour, which will continue to bring income back to a more moderate but more autonomous trend.

HOUSEHOLDS: LESS PRECAUTIONARY SAVINGS AND MORE INVESTMENT

A SAVINGS SURPLUS THAT WILL EXACERBATE STAGNATING PURCHASING POWER

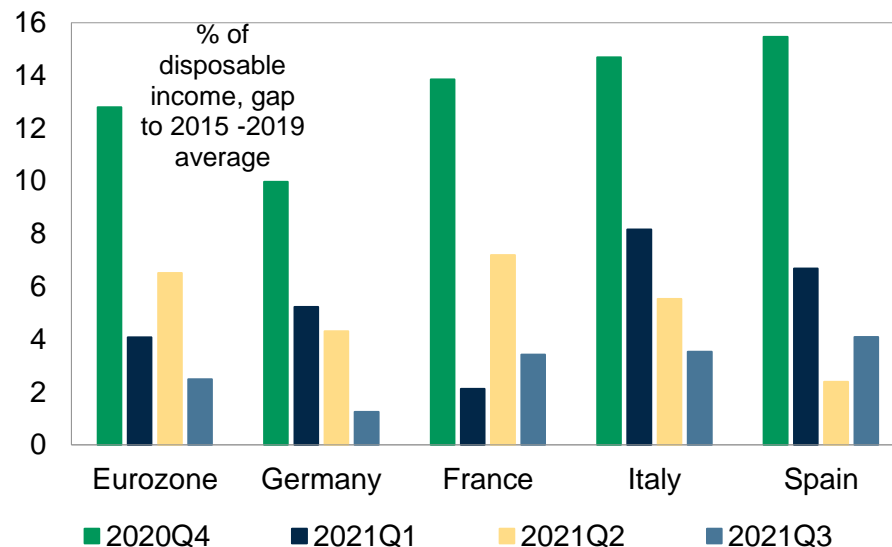
Allocation of savings



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

The normalisation of consumption is accompanied by the normalisation of savings and investment behaviour, with a fall in investment in liquid assets, but a increase in investment in housing supported by still substantial credit flows. Asset valuations continue to play a role in supporting household income with significant wealth effects.

Excess savings



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

Despite the decline in the savings rate that has been underway for two quarters, the savings surplus accumulated with the pandemic has not yet been eroded.

It can continue to support consumption, especially in 2022 when still high inflation will erode the purchasing power of a income that is seeing its growth moderate. As such, the gap in consumption compared to the pre-pandemic period will be closed by the summer of 2022.

FIRMS : NORMALISING PROFITABILITY

INVESTMENT: CATCH-UP COMPLETE, PUBLIC AND PRIVATE DEMAND ARE SOLID

After a very steady trend at the end of 2020 and again in Q2 2021 (+1.3%), investment in volume terms fell back in Q3 (-0.9% over the quarter). This is the effect of the decline in construction investment (-0.9%), which has been more apparent in the housing sector (-1.2%) than in other construction (-0.6%), but above all the sharper decline in investment in transport goods (-8.6%). Growth in other productive investment (machinery and equipment and ICT) remains positive, but is slowing. It is primarily the decline in German investment (-2.2%) that has slowed down accumulation in the eurozone, since investment growth has remained positive elsewhere: 1.6% in Italy, 1.2% in Spain and barely 0.1% in France.

Corporate profitability remains high despite a gradual withdrawal of public support measures, which brings it back to more “normal” levels. The profit share of eurozone companies fell in Q3 (to 40.4% of value added after 41.4% in Q2). Pay rose by

3% as a result of the increase in employment (+0.9%) and hours worked (+2.2%) as well as in compensation per head (2% after 0.2%). This increase was faster than the rise in productivity (+1.3%) and led to a recovery in unit labour costs (+0.7%). However, taxes net of subsidies also eroded profitability: up 2.2% for the quarter, reversing their downward trend. This is the logical consequence of the normalisation of activity, which can be seen in the very strong growth of value added in the trade, transport, hotel and restaurant sectors, and which has led to a decline in government support to help shore up companies' cash flow and profitability.

However, investment by NFCs recovered in value terms (0.9% over the quarter), but not enough to halt the decline in the investment rate (to 23% from 23.6%). As a result, the financing capacity has fallen slightly, without hindering the growth of financial investment. **Like households, businesses have also limited their**

precautionary investment with a clear slowdown in investment in liquid assets, which is returning to more normal levels.

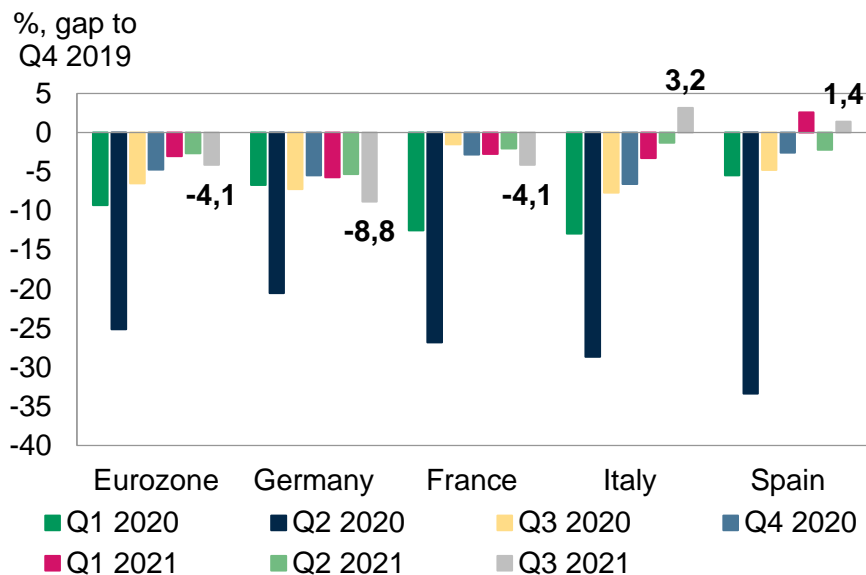
The rate of debt growth increased, with the acceleration in bond and bank debt (3% year-on-year after 2.3%) offsetting the fall in equity issues. The share of NFC debt in GDP nevertheless continued to fall (to 79.8%, down two points year-on-year).

Maintaining high profitability will be able to draw on a more favourable productivity cycle. Investment can continue to rely on companies' good health and on private and public demand supported by the stimulus plans (growth of 5.8% expected in 2022 and 4.4% in 2023 after 3.6% in 2021). The negative contribution of investment in transport goods is expected to remain but should gradually fade.

INVESTMENT : CATCH-UP COMPLETE IN MACHINE AND EQUIPMENT

BUT TRANSPORT IS STILL LAGGING

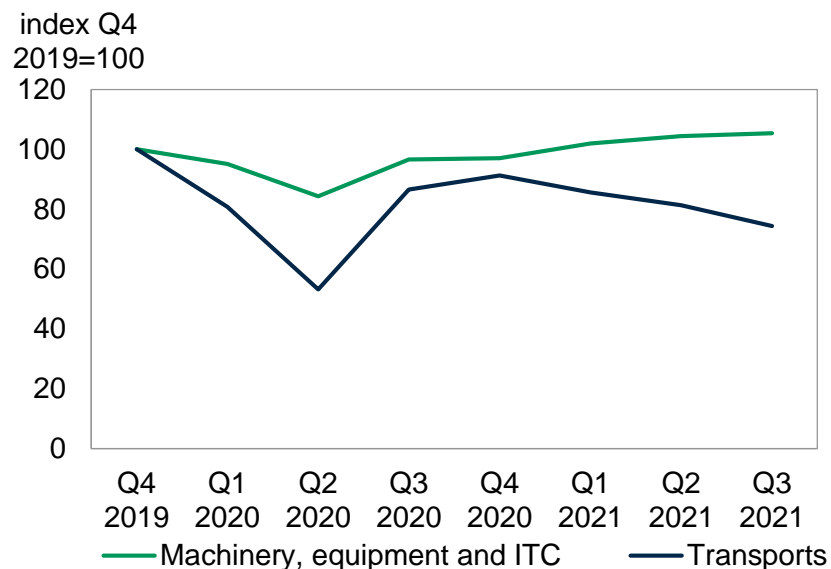
Productive investment : gap to pre-crisis level



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

In Q3, productive investment fell by 1.5% due to the more pronounced decline in investment in transport goods (-8.6%). Growth in other productive investment (machinery and equipment and ICT) remains positive, but is slowing (+0.9%). This slowdown nevertheless comes after very strong growth (5.6% on average per quarter) in the previous four quarters.

Productive investment : very different performances



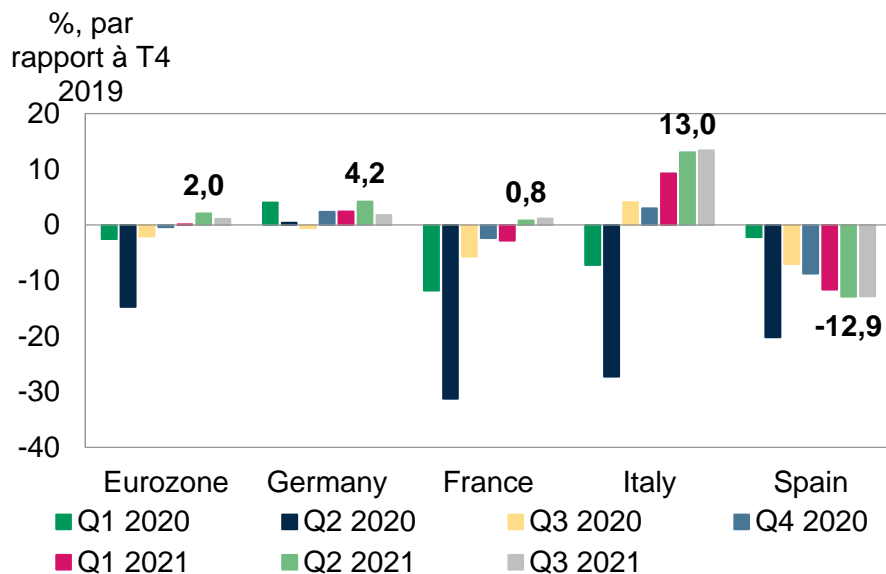
Sources: Eurostat, Crédit Agricole S.A./ECO

Investment in transport goods continued to decline in all countries in Q3, particularly in Germany. Its level is still a quarter lower than before the crisis and more so in Germany, while it is lagging less in France (-12.6%). It is estimated to have removed 0.3 percentage points from the zone's cumulative GDP growth in the first three quarters of 2021. Productive investment other than in transport goods returned to its pre-pandemic level in all the major countries of the zone and far exceeded it in Italy and Spain (+11.2% and +13.4% respectively).

INVESTMENT : PRE-CRISIS GAP CLOSED IN CONSTRUCTION

SPAIN IS LAGGING FAR BEHIND

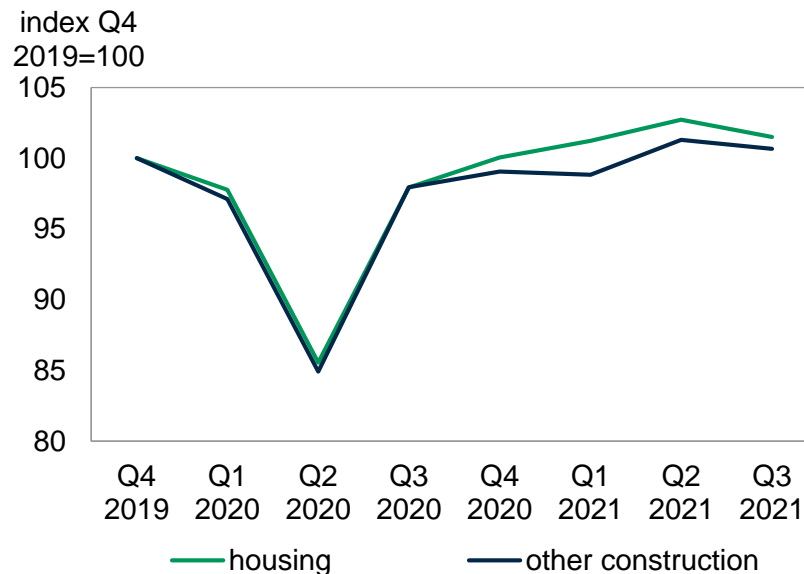
Construction investment : gap to pre-crisis level



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

In Q3, construction investment declined (-0.9%), more substantially in the housing sector (-1.2%) than in other construction (-0.6%). This is mainly the result of the decline in German investment, which remains positive but is weakening elsewhere.

Construction investment : an even recovery



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

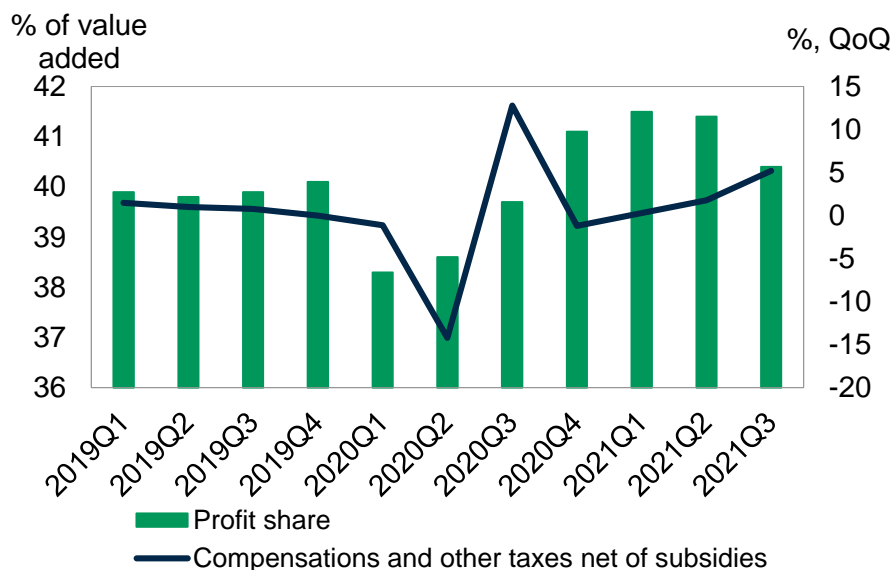
All the major economies in the zone have exceeded their pre-crisis level, with the exception of Spain, where the gap is considerable (-12.9%).

Demand remains strong, driven by household spending on housing, the positive effect of stimulus packages that support housing renovation, and also by major infrastructure projects.

FIRMS: HIGH BUT NORMALISING PROFITABILITY

LESS PRECAUTIONARY FINANCIAL SAVINGS

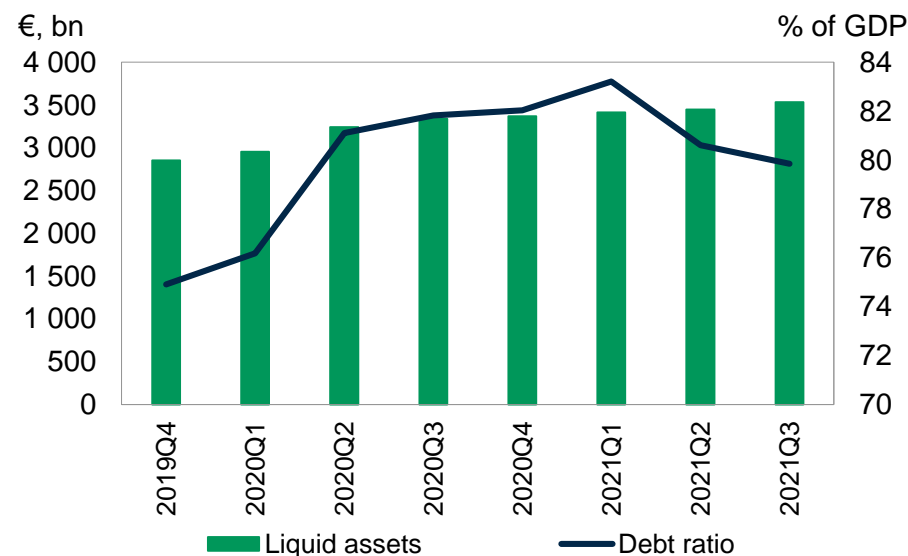
Gradual reduction in subsidies and higher compensation are normalising profitability



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

Pay rose by 3% as a result of the increase in employment (+0.9%) and hours worked (+2.2%) as well as in compensation per head (2% after 0.2%). However, taxes net of subsidies also eroded profitability: up 2.2% for the quarter, reversing their downward trend. The profit share of eurozone companies fell in Q3 (to 40.4% of value added after 41.4% in Q2).

Investment in liquid assets slowing down, but high levels of assets and falling debt ratio



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

Like households, businesses have also limited their precautionary investment with a clear slowdown in investment in liquid assets, which is returning to more normal levels.

The rate of debt growth increased, with the acceleration in bond and bank debt (3% year-on-year after 2.3%) offsetting the fall in equity issues. The share of NFC debt in GDP nevertheless continued to fall (to 79.8%, down two points year-on-year).

CONTENTS

1 SUMMARY

2 RECENT ECONOMIC TRENDS

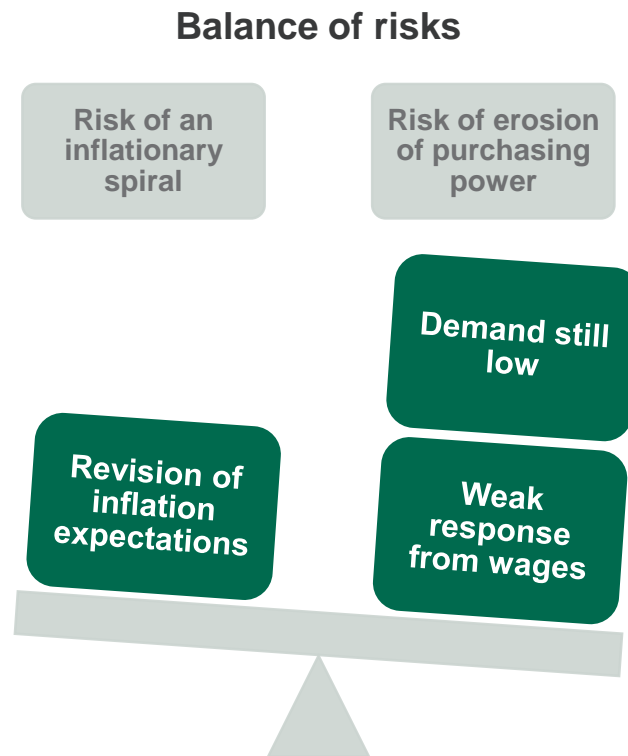
3 SCENARIO

4 | FOCUS: THE LINK BETWEEN INFLATION AND EMPLOYMENT

5 POLICY MIX

FOCUS: INFLATION AND EMPLOYMENT – ALWAYS TOGETHER

A NOT QUITE COMPLETE BUT MODERATELY REFLATIONARY RECOVERY



Source: Crédit Agricole S.A./ECO

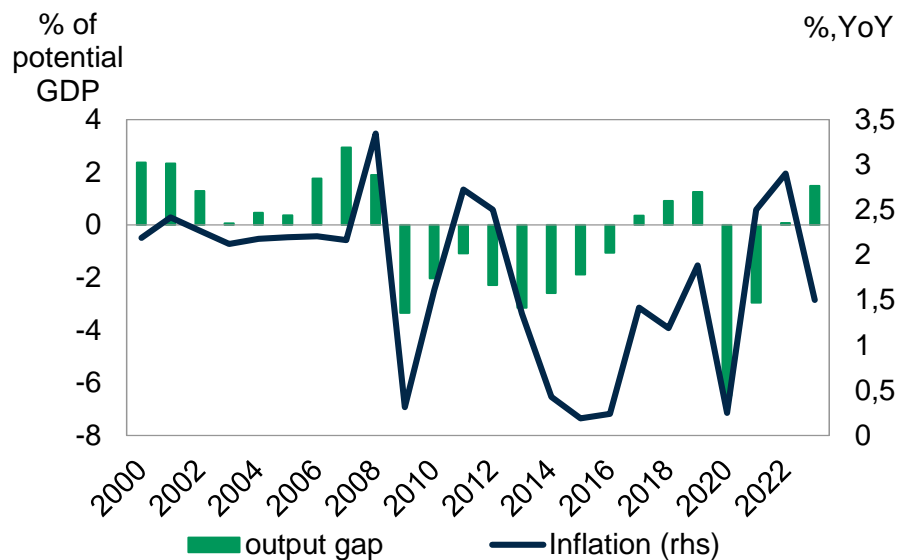
Despite the strength of the rebound, aggregate demand is still weak, which is consistent with the modest uptick in wages and the more persistent, albeit temporary, rise in inflation.

The main risk of rising inflation is its impact on growth, as inflation erodes purchasing power, rather than on expectations that could fuel a price-wage spiral.

FOCUS: INFLATION AND EMPLOYMENT – ALWAYS TOGETHER

LESS DAMAGE TO PRODUCTION CAPACITY KEEPS DEFLATIONARY RISK AT BAY

Eurozone: negative output gap closed quickly

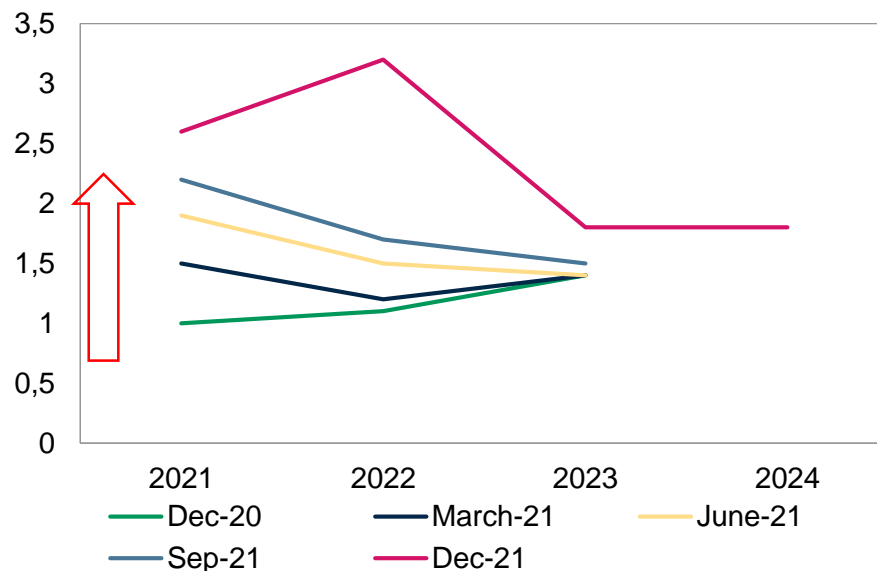


Sources: Eurostat, Crédit Agricole S.A./ECO

Contrary to initial fears, the negative output gap closed by the crisis will be eliminated during our forecast horizon.

This rapid tightening contrasts with the past experience of the great economic and financial crisis, after which the negative output gap and excess capacity persisted for a decade, contributing to the strong deflationary pressures experienced during the 2010s.

Revision of ECB inflation forecasts



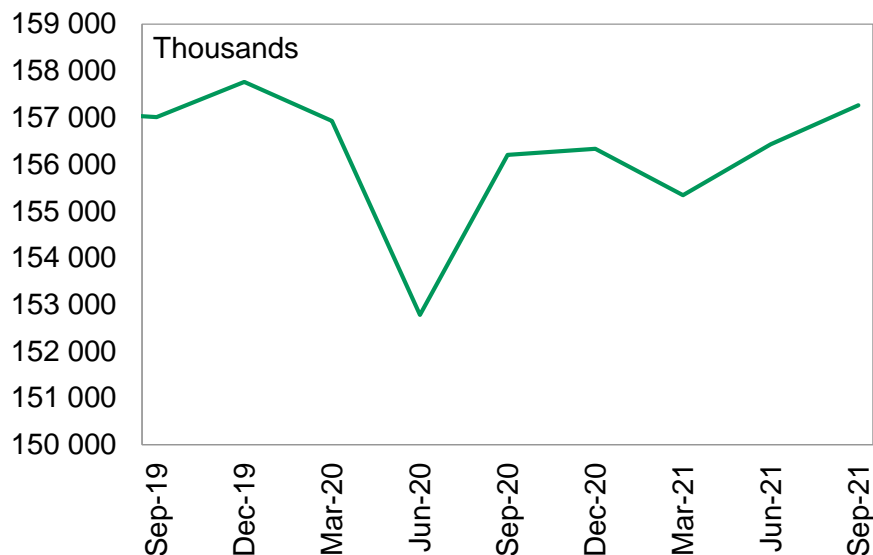
Sources: ECB, Crédit Agricole S.A./ECO

The ECB has gradually raised its inflation forecast for 2022 from 1.7% to 3.2%, but this revision is much more modest for 2023 (from 1.5% to 1.8%) and its inflation projection for 2024 is still below its target. Inflation is therefore still transitory and determined by a supply shock with limited effects on core inflation, whose forecast has been revised upwards from 1.4% to 1.9% in 2022 and from 1.5% to 1.7% in 2023.

FOCUS: INFLATION AND EMPLOYMENT – ALWAYS TOGETHER

LIMITED SOURCES OF PERMANENT INFLATION FROM THE LABOUR MARKET

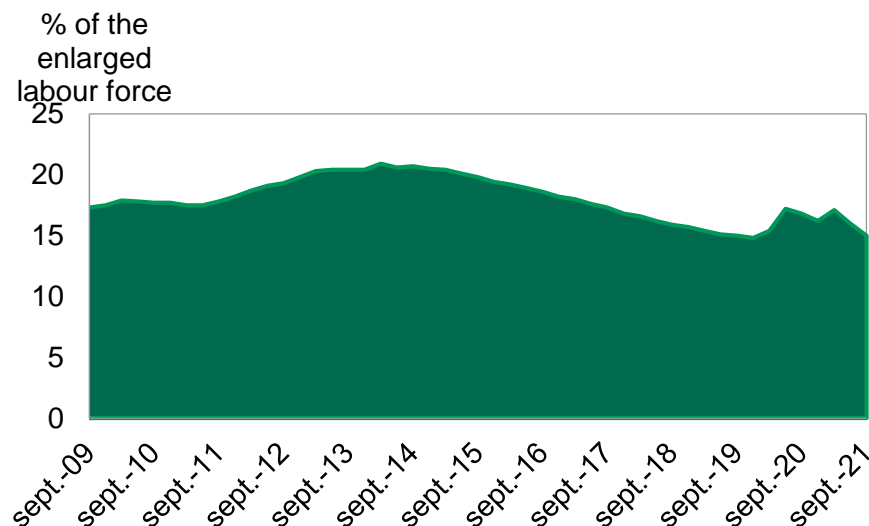
Eurozone: Labour force



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

We are not seeing (or not yet) in the eurozone the withdrawal of activity that has affected the United States and which seems to be structural, leading to a permanent reduction in the labour supply and thus increasing the equilibrium unemployment rate (the NAIRU or Non-Accelerating Inflation Rate of Unemployment), which is causing an increase in wage pressure and a transition to a more inflationary regime.

Surplus capacity on the labour market



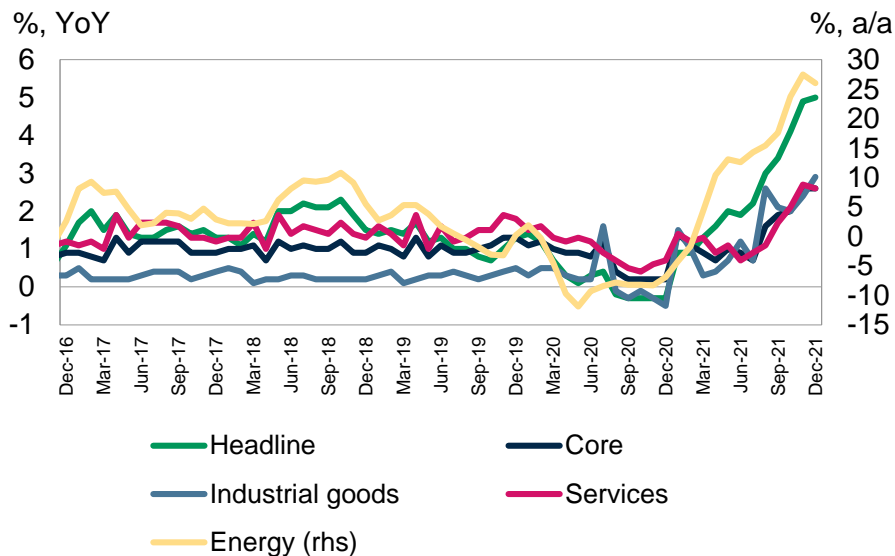
Sources: Eurostat, Crédit Agricole S.A./ECO

In the eurozone, temporary withdrawals from the labour market did occur, but a large proportion of them were reflected in a return to the labour market as soon as activity recovered. Thus, the short-time work mechanism, which preserved the link with the job, may have reduced the likelihood of permanent displacement. The unemployment rate has quickly returned to its pre-crisis level and the reduced surplus capacity on the labour market increases the likelihood of somewhat (but moderately) more inflationary growth.

FOCUS: INFLATION AND EMPLOYMENT – ALWAYS TOGETHER

HIGH INFLATION BUT LIMITED SECOND ROUND EFFECTS

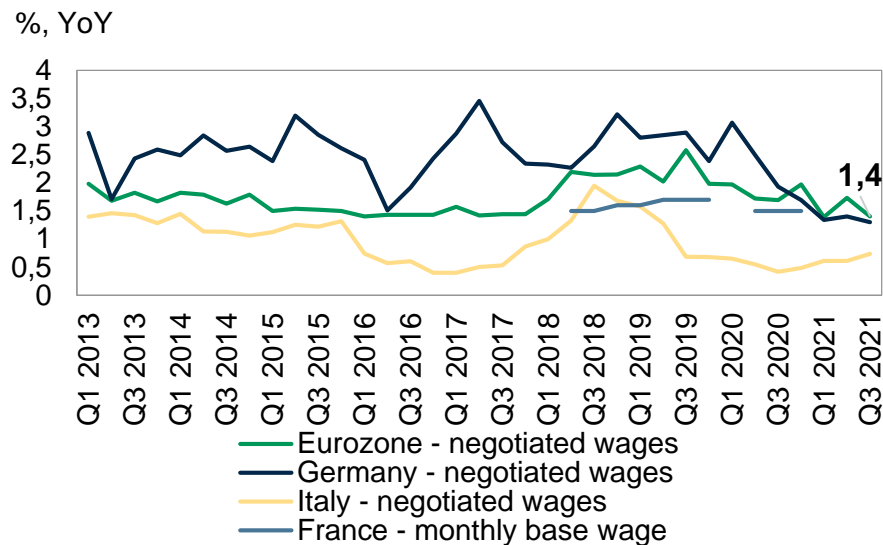
Inflation: some second-round effects on goods



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

Eurozone inflation reached a new high in December (5% year-on-year after 4.9% in November). As such, inflation stands at an annual average of 2.6% in 2021, in line with our forecast. The acceleration in price growth is taking place despite the weakening of the rise in energy prices (+26% year-on-year after 27.5%), while the more stable components of inflation are stabilising overall. Core inflation stood at 2.6% in December as moderating growth in services prices was offset by accelerating growth in industrial and food goods. It is forecast to reach 3% in 2022 and fall to 1.5% in 2023.

Negotiated wages: very moderate trend



Sources: ECB, Bundesbank, Insee, Istat, Crédit Agricole S.A./ECO

The risk of a broad and automatic pass-through of recent inflation increases to wage growth seems rather low because for more than half of private sector employees in the eurozone, inflation does not play a formal role in wage setting, but it can be an important factor in wage bargaining, however wage bargaining mainly uses a measure of inflation that excludes energy. Wage negotiations in 2021 produced limited increases of 1.4% in Q1, 1.7% in Q2 and 0.4% in Q3. Growth of 3.7% in 2021 and 2.4% in 2022 in effective wages is forecast, with a still strong overhang in early 2022, but weakening momentum.

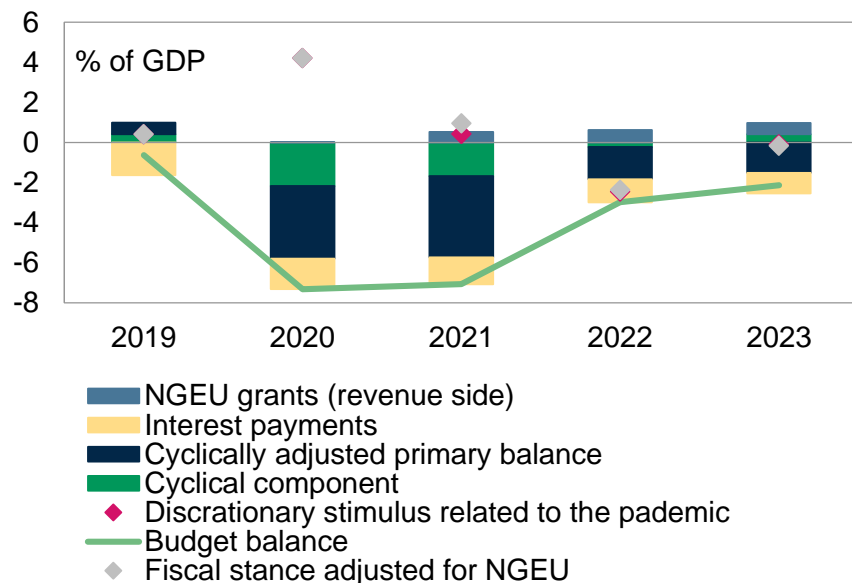
CONTENTS

- 1 SUMMARY
- 2 RECENT ECONOMIC TRENDS
- 3 SCENARIO
- 4 FOCUS: THE LINK BETWEEN INFLATION AND EMPLOYMENT
- 5 | POLICY MIX

VERY GRADUAL AND CAREFUL WITHDRAWAL OF SUPPORT

FISCAL POLICY: EUROPEAN SUPPORT AND RELAXATION OF RULES

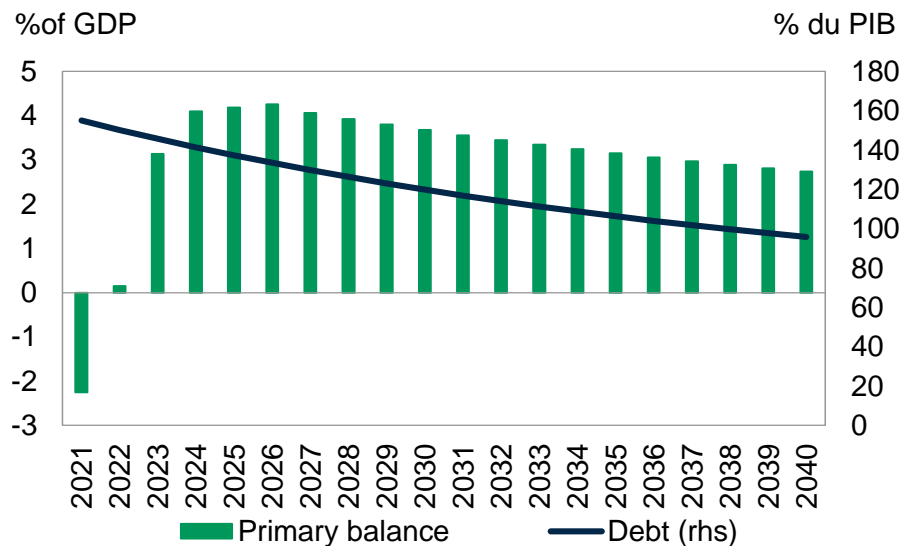
Budget balance and fiscal stance



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

After the strong support generated by fiscal policy in 2020, the new impulse provided in 2021 is barely positive and becomes negative in 2022 and 2023, when the structural deficit is reduced. The European funds of the NGEU do not fully offset this reduced support at the aggregate eurozone level, but they are significant in maintaining a less negative impulse in the southern countries, which are major beneficiaries of European funds.

Public finance trajectory under SGP rules – Italy



Sources: Crédit Agricole S.A./ECO

The Stability and Growth Pact's budget rules are suspended until the end of 2022, but it seems unlikely that they will be reintroduced unchanged. The legacy of high debts left by the pandemic makes it impossible to apply the rules to the letter without imposing unsustainable fiscal constraints on the most indebted countries and thus undermining the recovery. Minor changes are expected, but the political consensus around them has yet to be built.

VERY GRADUAL AND CAREFUL WITHDRAWAL OF SUPPORT

MONETARY POLICY: INSURANCE AGAINST EARLY NORMALISATION

I) Reaffirm inflation strategy and guide interest rate expectations; accompany the withdrawal of emergency support with a significant and flexible presence on the sovereign market.

The three conditions that must be met before a first rate increase:

- Inflation must reach the 2% target well before the end of the ECB's projection horizon.
- This target must be achieved on a sustainable basis until the end of the projection horizon.
- The progress made in terms of core inflation must be sufficiently advanced to be compatible with inflation stabilising at its target level in the medium term.

In its December 2021 projections, the ECB expects inflation to be 3.2% in 2022 and 1.8% in 2023 and 2024, which is still below its target, despite its still very accommodating policy stance

VERY GRADUAL AND CAREFUL WITHDRAWAL OF SUPPORT

MONETARY POLICY: INSURANCE AGAINST EARLY NORMALISATION

II) Accompanying the withdrawal of emergency support through a significant and flexible presence in the sovereign market.

A balance sheet that will continue to expand until at least the end of 2022, despite the end of the pandemic programme, in order to ensure that the flow of securities purchases corresponds to sovereign issues and to avoid too strong and unjustified steepening of the yield curve and any risk of fragmentation.

- Purchases under the Pandemic Emergency Purchase Programme (PEPP) reduced from October 2021 and ended in March 2022.
- Reinvestment period extended to the end of 2024 while maintaining full flexibility of purchases across jurisdictions and asset classes.
- Asset purchases in the traditional APP temporarily increased in 2022.

We expect a new TLTRO programme to be announced with less favourable conditions than the TLTROIII)

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