2 February 2023

# Euro macro notes

## From recession to stagnation

- **The near-term prospects of the euro area economy have brightened and we revise our GDP forecasts upwards amid a more balanced risk picture (see table).**
- **A full-fledged recession will likely be avoided, but a strong recovery is not yet in sight as monetary headwinds persist. Stagnation still defines the growth outlook.**

**The euro area economy weathered the energy crisis and inflation shock of 2022 better than feared**, avoiding a GDP contraction in Q4 22 (+0.1% q/q), despite bleak consumer and business sentiment. However, the economy's seeming resilience stemmed partly from Irish distortions (where GDP rose 3.5% q/q in Q4), while some tailwinds are also a leftover from the past. A high order backlog and easing supply bottlenecks supported manufacturing activity. Robust labour markets and government support measures, cushioned the blow to household finances. Helped by unseasonably mild weather, companies have proved unexpectedly flexible at dealing with high energy costs and energy crisis fears have abated amid high gas storage levels and new LNG terminal capacity coming online as planned.

**Leading indicators have turned the corner and suggest the worst of the economic downturn lies behind us for now** (see also *Research Global - Global manufacturing PMI heading higher in H1*, 25 January). Chinese pent-up demand will likely boost activity in the near-term (see also *Euro macro notes - The China connection: short-term boost, long-term worry*, 12 January). Unemployment remains at rock-bottom and surveys suggest firms intend to hire more, rather than plan large scale job cuts. High vacancies provide an additional cushion for the labour market and we expect rising wage growth to remain a feature for 2023.

**However, not falling off the cliff is one thing, staging a strong rebound is quite another matter.** Despite the more upbeat near-term outlook, we see few reasons that point to a strong euro area recovery any time soon. While fiscal policies have been effective in avoiding some worst-case recession scenarios, their tailwind will increasingly fade in 2023. Country figures suggest domestic demand might already be in recession and with 'sticky' core inflation, consumers face another year of real income losses. It also seems too early to declare an end to the energy crisis just yet, as prices remain well above normal levels and the risk of attacks on European energy infrastructure remains. The economy has also yet to feel the full impact of the ECB's monetary tightening. Higher mortgage rates have already started to cool construction and housing market activity and leave downside risks also for business investments. Consequently, we still see foresee a renewed downturn in economic activity during H2 23, before a more gradual recovery takes shape in 2024.

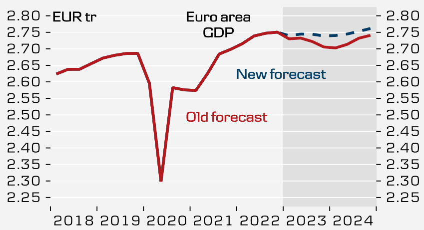
**Challenging times lie ahead especially for Germany's economy, whose growth model remains in an adjustment phase.** German industry remains pessimistic about its competitive position and although Chinese demand could give a welcome boost to exports in the near-term, structural issues such as 'slowbalisation' and a shrinking workforce set the scene for a muted growth outlook. Stepped up investments on infrastructure, digitalisation and the green transition provide a silver lining, but until the energy crisis is truly resolved, Germany is unlikely to return as the euro area's economic powerhouse anytime soon.

### Improved euro area growth outlook...

| | | New forecast | | Previous forecast | |
|---|---|---|---|---|---|
| GDP (%) | 2022 | 2023 | 2024 | 2023 | 2024 |
| Euro area | 3.5 | 0.1 | 0.3 | -0.9 | 0.0 |
| Germany | 1.9 | -0.4 | 0.1 | -1.4 | -0.5 |
| Unemployment | | | | | |
| Euro area | 6.7 | 6.9 | 7.0 | 7.4 | 8.3 |
| Germany | 3.0 | 3.3 | 3.5 | 3.8 | 4.2 |

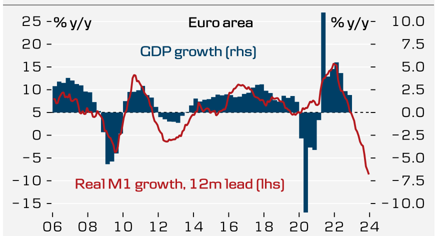
*Source: Eurostat, Macrobond Financial, Danske Bank*

### ...But strong rebound not yet in sight




*Source: European Commission, Macrobond Financial, Danske Bank*

### Downside risks from tighter monetary conditions




*Source: ECB, Eurostat, Macrobond Financial, Danske Bank*

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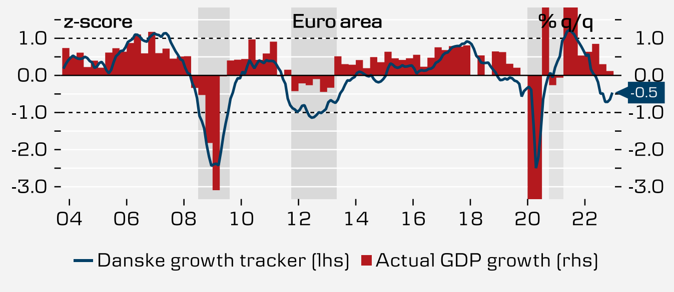
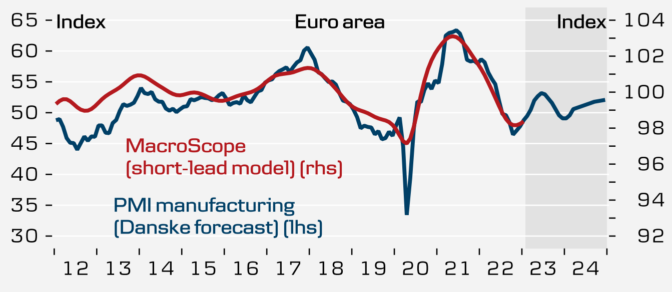
**Leading indicators have turned the corner**



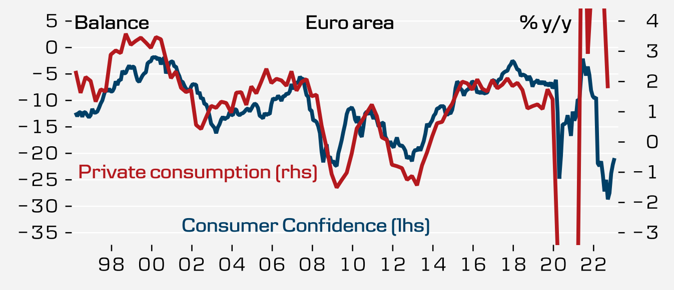

*Source: Eurostat, Macrobond Financial, Danske Bank*

**MacroScope points to further upside for euro area PMIs**



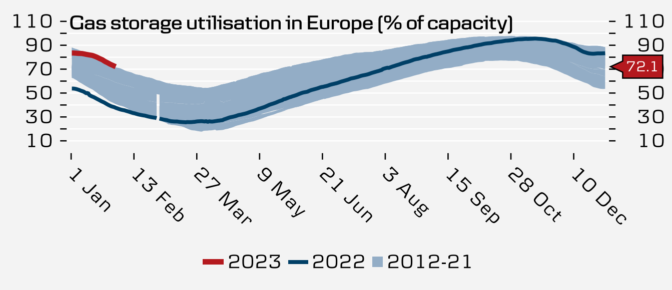

*Source: Markit, Macrobond Financial, Danske Bank*
*Read more about MacroScope here.*

**Bleak consumers point to downside risks for private consumption**



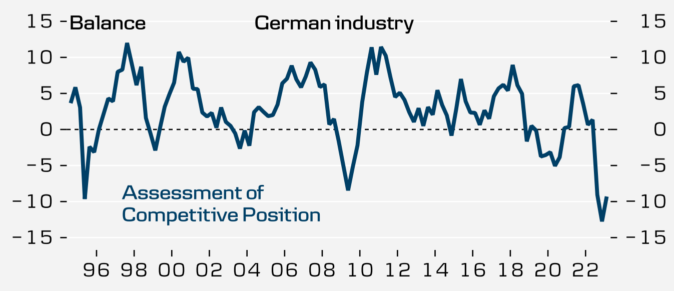

*Source: Eurostat, European Commission, Macrobond Financial, Danske Bank*

**Energy prices have declined sharply as mild weather has supported gas storage levels**



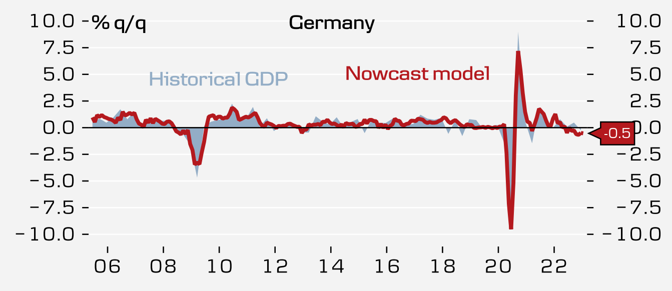

*Source: GIE, Macrobond Financial, Danske Bank*

**German industry remains pessimistic about its competitive position**



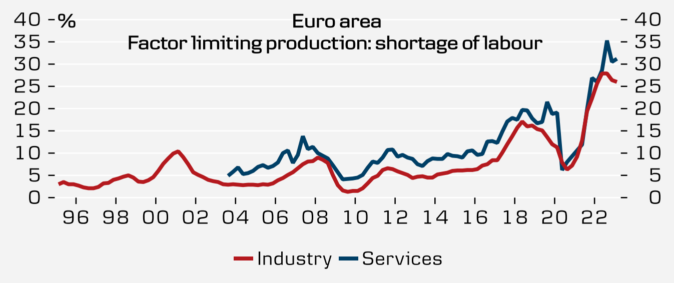

*Source: European Commission, Macrobond Financial, Danske Bank*

**Germany's economy is not out of the woods**



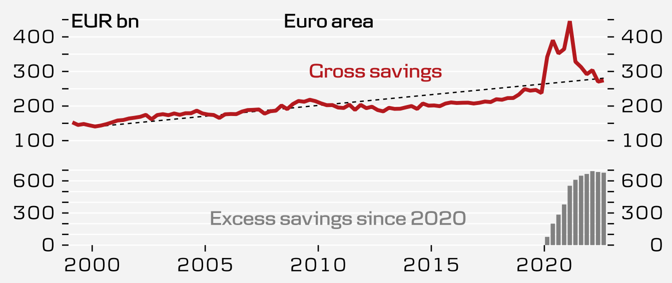

*Source: Macrobond Financial, Danske Bank*
*Note: Nowcast model uses truck toll mileage, Bundesbank's weekly activity index, IFO, consumer confidence, exports and industrial production data*

**Labour shortages persist, especially in services**




*Source: Eurostat, European Commission, Macrobond Financial, Danske Bank*

**Private sector finances remain on a strong footing**




*Source: Eurostat, Macrobond Financial, Danske Bank*

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