

Eurozone: A delayed recovery

With more stringent lockdowns in the offing and a still underwhelming vaccination campaign, the eurozone economy is likely to shrink again in 1Q. A recovery can still be expected from 2Q, though some headwinds remain. Inflation is likely to be temporarily higher. Meanwhile, the European Central Bank seems to be moving towards yield curve control



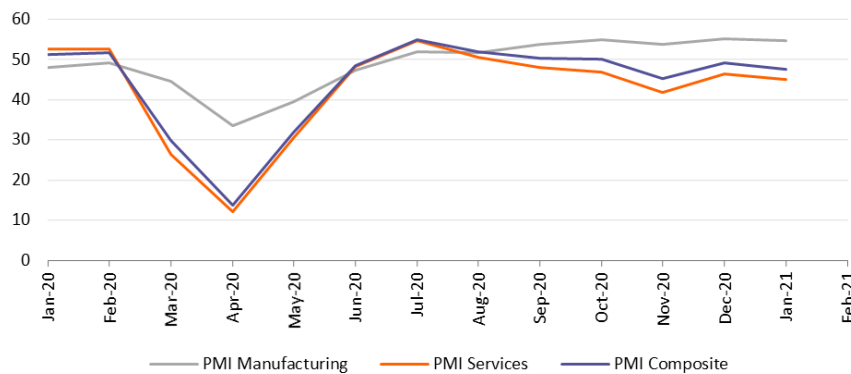
German Chancellor
Angela Merkel

Source: Shutterstock

A weak January

The eurozone economy most probably shrank in the fourth quarter, though the contraction might be slightly smaller than we previously anticipated. According to provisional estimates, the German economy has apparently avoided recession, with strong exports providing important support. However, the build-up of inventories in the UK in the run-up to 2021, pushing up imports from the continent, is likely to reverse. Initial economic data for 1Q already signals some weakening. The German Ifo indicator dropped more than expected in January, with both the current conditions and the expectations component weakening. Eurozone consumer confidence also fell back in January, while the composite PMI slid to 47.5 from 49.1 in December.

PMIs soften in January



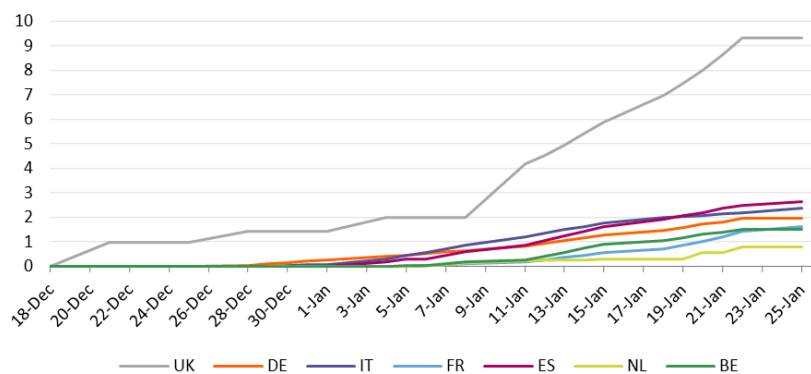
Source: Refinitiv Datastream

Underwhelming vaccination campaign

With the more contagious British and South-African Covid-19 strain spreading on the continent, lockdown measures have tightened again in several countries. The Netherlands introduced a curfew and France has tightened the existing one to 6pm. At the same time, the vaccine campaign continues to disappoint. While in the UK, around 11% of the population has been inoculated, in most eurozone countries, this was less than 2%. To make things even more painful, Pfizer had to reduce the deliveries of the vaccine to allow for changes in the production line. At the same time AstraZeneca, whose vaccine is not yet even approved, announced that it would deliver 60% fewer doses than promised in the first quarter. With these additional hurdles, it seems unlikely that herd immunity will be reached before the fourth quarter across the eurozone. That said, with the most vulnerable people probably inoculated by the end of April, some loosening of containment measures still looks likely. So after a difficult start of the year, we still stand by our recovery story from the second quarter onwards. However, the risk is that the number of infections remains high for some time to come. The political turmoil in Italy is not helping either, while the slow rollout of the plans to get money from the European Recovery Fund is also limiting the speed of the recovery. That is basically why we are looking at a sub-consensus 3.5% GDP growth rate in 2021 and 3.7% in 2022.

Slow vaccination pace

% of the population inoculated



Source: Refinitiv Datastream

Inflation might (temporarily) surprise

A VAT hike in Germany, higher energy prices and expected price hikes when some services reopen (see [here](#)) mean that inflation will come in higher this year. We expect an above-consensus average inflation rate of 1.3% for the year, with a 2% inflation rate at the start of the third quarter not out of reach. From the fourth quarter onwards, inflation should soften again and we expect it to settle around 1.3% in 2022. Given the fact that the inflation uplift is only temporary, the ECB is unlikely to react. What's more, by the summer months the ECB will probably have announced its new strategy. We expect the bank to go for an inflation target "around 2%", which allows for temporarily higher inflation without the need for a policy change.

Yield curve control by another name

For the time being, the ECB is certainly not thinking of tightening. Because of the huge negative output gap and the struggle to emerge from the pandemic-induced recession, loose monetary policy will still be required for some time to come. There is however a slight shift in the ECB's approach. The bank has now put the aim to preserve "favourable financing conditions" at the centre of its policy. While this sounds rather vague, it's obvious that long-term interest rates are an important determinant of financing conditions. As such, the ECB's Chief Economist Philip Lane declared that the Pandemic Emergency Purchase Programme has an important role to play in ensuring that the middle and long-end segments of the yield curve remain "appropriate". And that a premature steepening of the yield curve should be avoided. We read: yield curve control by another name. While we still expect long-term bond yields to rise somewhat during the year, the ECB bond purchases will probably limit the increase to 25bp by the end of this year.

Author

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security

discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.