

Peter Vanden Houte: Eurozone growth is already dwindling

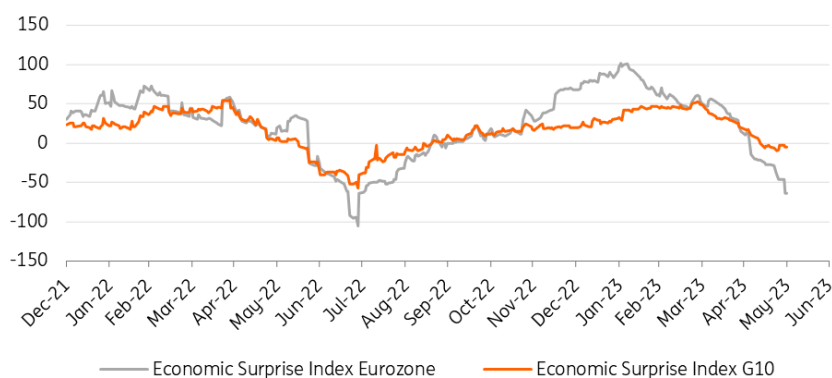
On the back of a weak first-quarter performance for the eurozone economy, we have downgraded our growth outlook. That said, we now pencil in two more rate hikes, as core inflation is unlikely to come down much before autumn. We might be too pessimistic about growth, though an even worse scenario cannot be dismissed either



Eurozone view: weak growth with falling inflation

Eurozone growth disappointed in the first quarter. While falling energy prices and rising wages should support consumption, the soft Chinese reopening, tighter monetary conditions and looming US recession will weigh on growth and bring the economy close to a standstill by year-end. It is mainly services that are currently thriving. The manufacturing sector is struggling with excess inventories while construction is hampered by higher interest rates. It is therefore not surprising to see that services inflation remains quite sticky, while there are budding deflationary pressures in the goods industry. But the further weakening of growth over the course of the year should bring inflation down towards 3% by year-end. As the ECB wants to see a clear decline in core inflation before ending the tightening cycle, 25bp rate hikes seem likely in both June and July, with an additional one in September a genuine risk.

Eurozone data has been disappointing lately



Source: Refinitiv Datastream

Where we differ

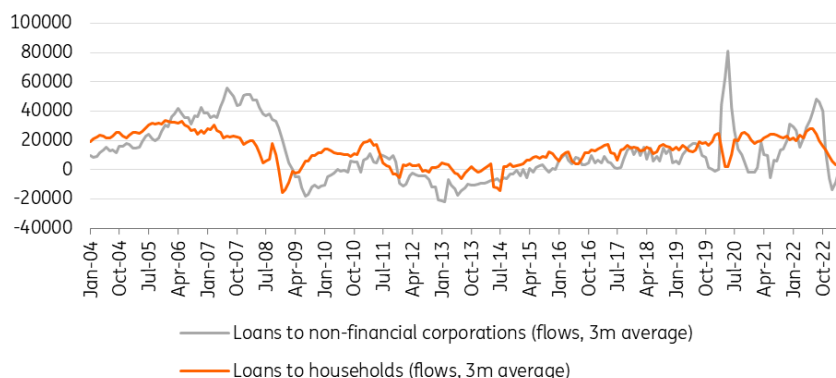
With our 0.5% GDP growth forecast for both 2023 and 2024, we are definitely below consensus (0.6% and 1.0% respectively) and far below official forecasts (for instance, the European Commission foresees 1.1% for 2023 and 1.6% for 2024, quite similar to what the ECB is pencilling in). With our 5.4% inflation forecast for 2023 and 2.5% for 2024, we are close to consensus, but below official estimates, especially for 2024. Market forwards indicate rates plateauing at a level around 50bp above today's level in the second half of the year, with a first rate cut in the second quarter of next year, exactly in line with our predictions.

Goldilocks after all?

We might be overly pessimistic about the growth outlook. With wages picking up and inflation coming down on the back of further falling energy prices, consumption growth could accelerate in 2024, certainly if you also pencil in a decline in the savings ratio. The weakness in manufacturing might also be short-lived: once the inventory overhang has been corrected and consumer demand for goods picks up again, manufacturing should become a driver of growth. If at the same time the US manages a soft landing and Chinese growth gathers momentum, net exports could also support the expansion.

Finally, with the European recovery plan gaining traction, public investment should add to growth. This would be a kind of goldilocks scenario, with growth accelerating and inflation falling in 2024.

Credit growth is stalling



Source: Refinitiv Datastream

A deeper downturn is still a genuine risk

On the other hand, it is certainly possible to come up with a stronger downturn scenario (bear in mind that we haven't pencilled in any negative growth quarters for the next two years). What we find a bit strange, is that in the official forecasts, it seems as if tighter monetary policy does have very little effect after all – even though the ECB's (admittedly somewhat discredited) models are forecasting a significant negative growth impact of monetary policy, both in 2023 and 2024. Also, in the past, it has been very hard for the eurozone to decouple from the US. Therefore, a US recession might hit the eurozone more than we currently anticipate.

On top of this, throw in the possibility of a credit crunch: falling house prices and an inverted yield curve will make banks a lot more cautious. So, even though we are already more bearish than the consensus, we cannot dismiss the possibility that growth turns out to be even weaker. Of course, that might allow the ECB to cut back rates a bit more strongly over the course of next 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>.