

Eurozone: The recession is over

With another GDP contraction in the first quarter, the eurozone experienced a double-dip recession. However, as the vaccination campaign gains traction lockdowns can now be gradually lifted, heralding a robust recovery. GDP is still more than 5% below pre-pandemic levels, tempering the current producer price pressures on inflation



A few thousand people gathered at an illegal party in Brussels earlier in May. Restrictions are starting to ease

Double-dip recession

As expected, the eurozone's economy contracted again in the first quarter, this time by 0.6% from the previous three months, making the Covid-19 crisis officially a double-dip recession. However, with the vaccination campaign now finally gaining some momentum, the recovery should start to show up in the real data for the second quarter.

To be sure, the second quarter still started on a weak footing with lockdown measures being prolonged in many countries. But in most big eurozone countries, a gradual reopening is now foreseen in the course of May, supporting growth. While of course, not all households saved more during the pandemic, ING surveys showed that higher-income households did so and that nearly 75% of accrued savings were due to the inability to consume. It, therefore, looks a safe bet to expect consumption growth to drive the recovery.

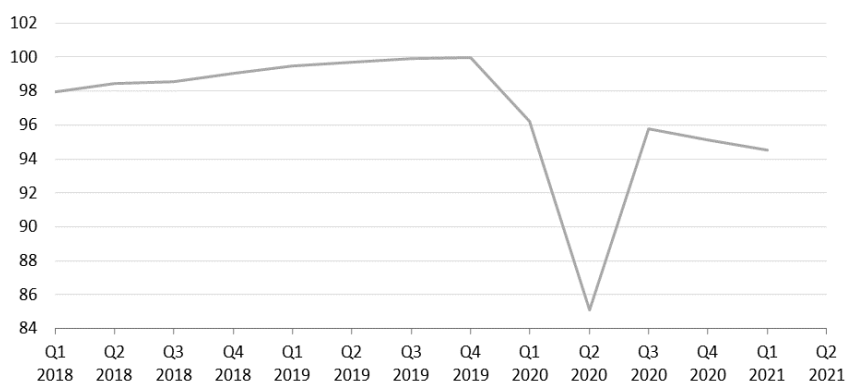
Recovery around the corner

The first sentiment data for 2Q corroborates this story. The European Commission’s economic sentiment indicator surged for the second month in a row in April, firmly above its long-term average. Industrial confidence is now at a record high, while sentiment in the service sector surprised with a hefty jump. It is very encouraging to see that all forward-looking indicators are rising.

Production expectations in industry reached their best reading on record, while inventories were considered as scarce as ever. Order books and demand expectations, as well as hiring intentions, are swelling in all sectors. While the petering out of the government support measures might still lead to an increase in bankruptcies in the course of the year, it doesn’t seem warranted to expect a big jump in the unemployment rate.

Admittedly, rapidly recovering demand is causing some supply chain problems in manufacturing, potentially hurting production, but this impact is likely to be dwarfed by the reopening of the services sector. We have therefore upgraded our second and third quarter growth forecasts, resulting in a 4.0% GDP growth for the whole of the year. 2022 should still see 3.7% growth.

GDP still more than 5% below pre-pandemic levels



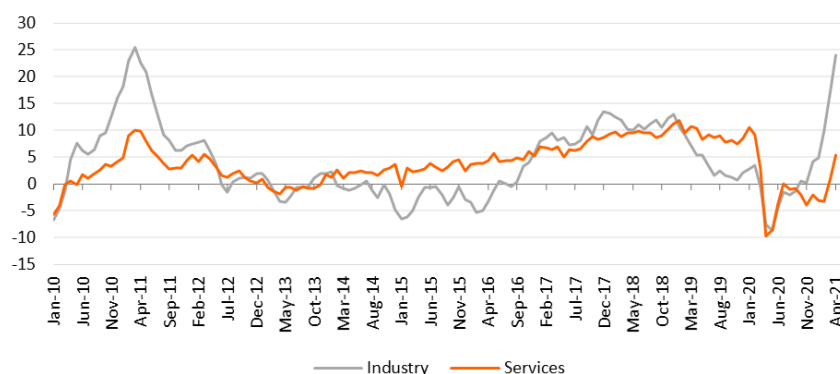
Source: Refinitiv Datastream

Pipeline inflation pressures

HICP inflation rose, as expected in April to 1.6% YoY on the back of higher energy prices. Core inflation on the other hand fell back to 0.8%. However, there are clearly signs of pipeline inflation: selling price expectations in industry are now close to a record high, but in construction, retail and even the services sector they are now above their long-term average.

With strong demand to be expected in the second half of the year and a further inventory build-up in the offing, we doubt that price tensions will disappear quickly. On top of that, the reopening of economic activities that are now closed because of lockdowns will most probably also trigger some price increases. On the other hand, the output gap is still negative and unlikely to be closed before 2023 or even 2024. In that regard, we stand by our scenario of temporarily higher inflation of 1.7% in 2021, falling back slightly to 1.6% in 2022.

Selling price expectations are rising



Source: Refinitiv Datastream

Higher bond yields

The inflation profile is unlikely to worry the European Central Bank. The bigger question is at what time the extraordinary stimulus should be taken away and some normalising of monetary policy should start. As the Pandemic Emergency Purchase Programme is closely linked to the pandemic situation it seems unlikely to be prolonged, unless some adverse second-round effects show up.

That's at least what board member Luis de Guindos seems to suggest: "*The normalisation of monetary policy should go hand in hand with the normalisation of the economy. Once the pandemic is over and the economy starts to get back to normal, then obviously monetary policy will also have to start doing the same.*"

That said, we still believe that the monthly Asset Purchase Programme bond purchases could be somewhat increased after PEPP has ended, to have a smoother tapering profile of quantitative easing. As for policy rates, we don't see them going up before the second half of 2023. However, with our new stronger growth profile we think that the ECB won't stop the 10-year Bund yield from going into positive territory before the end of the 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 www.ing.com.