

Eurozone: Inflation worries increase

After a strong third quarter, eurozone growth is likely to decelerate on the back of supply chain troubles, high energy prices and a pick-up in Covid-19 infections. Inflation continues to surprise on the upside, likely pushing the European Central Bank to take away some of the monetary stimulus next year



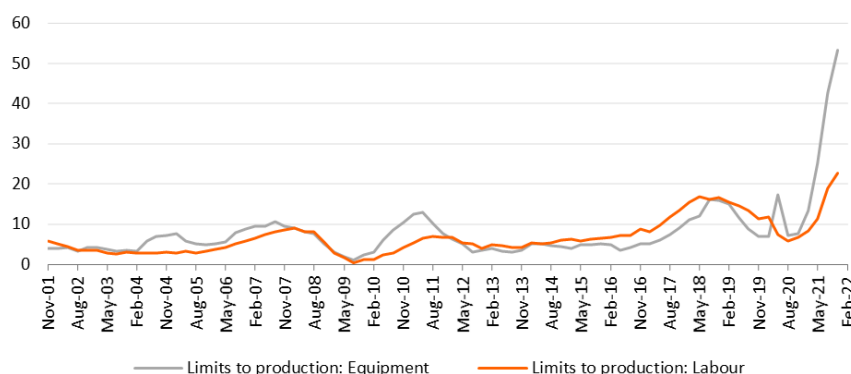
Europe Energy Crisis - Frankfurt Oct 2021

Source: Shutterstock

As good as it gets

With 2.2% quarter-on-quarter growth in 3Q, the eurozone recovery proved stronger than expected. The catch-up in the services sector, in particular, was the main driver of the robust growth figure. However, this is as good as it gets. Growth is bound to decelerate from the fourth quarter onwards, not only because we're now getting close to the pre-pandemic GDP level, but also because headwinds are becoming stronger. The supply chain troubles continue to rattle the manufacturing sector, with car manufacturers especially producing much less than they want to. On top of that, we see high energy prices sapping consumption, even though the strong labour market remains supportive. Finally, Covid-19 infections are picking up again. Admittedly, the high vaccination rate limits the burden on the health care system, but services consumption tends to suffer when the fear of getting infected increases.

Growing supply constraints are hampering manufacturing production



Source: Refinitiv Datastream

But there is still some growth momentum

As such, 4Q might see much weaker growth. That said, we certainly don't expect the recovery to falter again. Order book positions were close to historic highs in October, while hiring intentions remain very strong and consumers' perceptions of the labour market are increasingly buoyant. All of this means that even if growth turns out to be a bit weaker in the coming months – some catch-up seems likely in the course of 2022. We stand by our GDP growth estimates of 5.1% for 2021 and 3.9% for 2022.

Inflation forecasts revised higher (again!)

We expect inflation to fall in 2022, but remain above 2% until the second half of the year

The inflation story is getting more difficult to navigate for the ECB. The flash Harmonised Index of Consumer Prices (HICP) inflation estimate for October, came out at 4.1%. True, energy prices remain the main culprit, but core inflation also climbed to 2.1%. We agree with the ECB that there are still a lot of factors that might prove to be temporary. Higher services price inflation, which pushed up core inflation, is to a large extent due to its weak base a year ago. Likewise, the German VAT increase has added around 0.6 percentage points to eurozone inflation, an effect that will disappear in January 2022. That said, even though we don't believe oil and natural gas prices will continue to increase at the same pace in 2022 (we are actually forecasting a decline), the upward inflation impact might last a bit longer. The same holds true for goods price inflation, which has been pushed upwards by high commodity prices and shortages. And in an environment of tightening labour markets, wage agreements are likely to be a bit more generous, though the impact on inflation is unlikely to be felt before 2023 at the earliest. Summing it all up, we expect inflation to fall in 2022, but remain above 2% until the second half of the year. We have therefore revised our inflation forecast up yet again to 2.4% for 2021, 2% for 2022 and 1.8% for 2023. Thereafter, we might see a slight upward trend.

Long-term market inflation expectations are back at 2%



Source: Refinitiv Datastream

Taking away monetary stimulus

It is interesting to note that the 5 year 5 year forward inflation swap, the measure that was for Mario Draghi one of the warning signals that quantitative easing was needed in 2015, is now back around 2%. At the press conference after the monetary meeting, ECB President Christine Lagarde acknowledged that “market and survey-based measures of longer-term inflation expectations have moved closer to two per cent”. It, therefore, seems logical that the ECB will start to take away some of the stimulus: we expect a gradual decrease of bond purchases after the end of the Pandemic Emergency Purchase Programme in March 2022. A first rate hike will now happen, in our view, in the third quarter of 2023 ([for more details see our article on the ECB](#)).

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>.