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# Our three calls for the eurozone

From fiscal reforms to wage growth to inflation; these are three significant challenges for the eurozone in 2022


Eurogroup President Paschal Donohoe, top, European Commission President Ursula von der Leyen, bottom left, and ECB President Christine Lagarde

## 1 Still no fiscal reforms but silent power shift towards Brussels

The long-awaited discussion on how to modernise the eurozone's fiscal rules will gain momentum in the second half of the year after the French presidential elections. The new German government has kept the door open to some reforms, even if we warn against too much optimism. There have hardly been any coalition agreements in any eurozone country in the past, spelling out upfront a roadmap to eurozone reforms. On substance, we don't expect changes to the numerical fiscal rules but a shift towards a more pragmatic country-specific approach, balancing between debt sustainability and the need for investments. In this setup, the European Commission will play a more decisive and prominent role. In the meantime, the frontloading of investments planned by the new German government will find many eurozone followers, postponing any austerity to 2023.

## 2 Expect a rebound in wage growth for 2022

The pandemic has killed off the modest rise in wages seen in 2019 resulting in negotiated wage growth falling to an all-time low in the third quarter of 2021. However, this is where that low wage growth stops. Labour shortages have returned far quicker than expected, improving workers' bargaining power. The soaring inflation rate has already and will continue to result in higher wage demands from unions, while countries with inflation indexation will automatically see wages rise.

Finally, strong profits give corporates room to increase salaries. Admittedly, union power has weakened in recent years and differences between countries are big in job market pressures, which could dampen the average jump in nominal wages. Still, we expect an increase to 3-3.5% in 2022, which is above the peak seen in 2019.

## 3 Inflation will fall below 2%, but the ECB's medium-term target will be met

We agree with the ECB that the disappearing effect from the German VAT increase in 2021, an improvement of supply chain disruptions and a more favourable base effect for energy prices are likely to push inflation towards 2% in the second half of 2022. However, the output gap in the eurozone will turn positive next year and will be significantly marked in 2023 and beyond. In this environment we expect wages to increase more rapidly (see above) and some demand-driven price pressures will emerge, especially as services will be in a good position to increase prices. On top of that, the green transition will, at least in the first few years, lead to structurally higher energy prices. The ECB's staff forecasts from December 2022 are likely to show an inflation rate of around 2% over the forecasting horizon, a backdrop that would justify an initial rate hike in the first half of 2023.

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