

3 calls for the eurozone as concerns rapidly mount

The threat of recession amid persistently high inflation is contributing to growing angst for policymakers across Europe



European leaders appear to have their backs against the wall, figuratively and literally, as problems mount

1 A recession in the eurozone

While you can argue about the precise definition of a recession, we now pencil in two consecutive quarters of negative growth, starting in the second half of 2022. The uncertainty of the Ukraine war and falling real income growth are likely to take their toll on the consumer. On top of that, the energy shock is not going to abate in the coming months, on the contrary. While oil prices are not expected to decline, natural gas prices might actually still climb higher in the winter months as reduced supply will keep the market very tight. That will further sap purchasing power and could also lead to some (temporary) closures of energy-intensive production sites. Meanwhile, the strong inventory build-up in recent months could give way to an inventory correction in the second half of the year. Finally, let's not forget that Covid-19 has not disappeared and is likely to add to the disturbances in winter.

2 ECB hikes by 100bp and then stops

With stubbornly high inflation and longer-term inflation forecasts above 2%, the European Central Bank has clearly fallen behind the curve. The very gradual process of normalising monetary policy looks increasingly misplaced. This is why we expect the ECB to step up the pace of hiking interest rates, bringing the refi rate to 1% before the end of the year. The looming recession, not only in

the eurozone but also in the US, along with doubts about debt sustainability in the eurozone should prevent the ECB from going beyond the initial normalisation, keeping rates on hold in 2023.

3 Fiscal policy debate at full swing

We expect the European Commission to present its proposals on how to reform the eurozone's fiscal rules after the summer. With the ECB's anti-fragmentation tool, widening bond yield spreads and fears of a new euro crisis, the discussion of fiscal rules and debt sustainability will gain unexpected momentum towards the end of the year. Eventually, we expect this debate to lead to more powers and responsibilities but also more discretionary authority for the European Commission. A currently unused tool is the so-called Excessive Deficit Procedure on government debt. Up to now, this procedure was never started as it would practically put countries under endless fiscal surveillance. We expect the debate to not only lead to a stronger role for the European Commission but also to give more emphasis on expenditure and debt reduction.

Authors

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

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>.