Eurozone Quarterly: Leaving the pandemic behind

Still licking the economic wounds of the Omicron wave, eurozone countries are trying to leave the pandemic behind. Supply chains are improving and fiscal stimulus is still providing support, but high inflation remains a key challenge to the economic recovery

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Olaf Scholz was elected German Chancellor in December

The German economy went into hibernation at the turn of the year. New restrictions to tackle the fourth wave of the pandemic and the Omicron wave, as well as higher energy prices, dented private consumption and sent the economy into contraction in the fourth quarter. As a result of that weak fourth quarter, the likelihood of Germany being in an outright recession at the turn of the year has increased. High energy prices will continue to weigh on private consumption, even if social restrictions are lifted in the course of February. Also, even with some temporary relief from exports and industrial activity, the Omicron wave in Asia and the Chinese New Year clearly argue against a steep short-term improvement in supply chains. Maybe the German economy gets away with just one black eye and there won't be a part two to the winter contraction story, but in any case, the short-term outlook doesn’t look too good.

Rising like a Phoenix

Even if the economy were to fall into a technical recession, the downturn would be mild and short-lived and is unlikely to harm the labour market. Indeed, we stick to our view that the German economy will stage an impressive comeback in the spring. Why? Order books are richly-filled and new orders are still coming in, while inventories have been reduced to record lows. It is therefore only a matter of time, with a few more container and microchip shipments from Asia to Europe, before industrial production surges again.

Admittedly, geopolitical risks and high energy prices as a damper on both production and consumption could still spoil the growth party but the end of social restrictions and significant relief in global supply chains should combine to give the German economy an enormous boost.

We expect the German economy to finally return to its pre-crisis level at the end of 1Q 2022. This is much later than justified by one of the largest fiscal stimulus packages worldwide. Global supply chain frictions have simply delayed the positive impact from the crisis measures. However, delayed does not mean repealed, and the stimulus can still feed through to the economy. What's more, the new government has agreed on a significant fiscal stimulus package to kick-start investment into the green transition while also announcing an increase in the minimum wage of almost 30% in October this year. The government plans to front-load many of these stimulus measures, which should lead to another high fiscal deficit but at the same time, should support the economic recovery.

Structural challenges will re-emerge

As the economy leaves the pandemic behind, the structural challenges of the past will re-emerge. The new government is clearly trying to tackle the problem of too little investment and too few structural reforms, improving German competitiveness over the coming years. However, the government does not seem to attach too much priority to making the pension and health care systems more sustainable. The structural problem currently most pressing for the short-term outlook is labour shortages. Companies are desperately seeking employees as both recruitment plans and the lack of labour as a limiting factor to production are both at record highs. In fact, the labour shortage was already an issue in 2018 and 2019 but before wages could rise, the pandemic came. The drivers behind these labour shortages are the following: lack of EU labour mobility, demographics and skill mismatches. Interestingly, for the first time in years, there is currently a positive correlation between labour shortages and wage developments, suggesting that wage growth will accelerate. Eventually, higher wages will not be enough to tackle labour shortages. The government will have to think about automation, immigration and training.

All in all, we expect the German economy to quickly exit its period of hibernation by the spring. If we are right, the headlines accompanying the German economy this year could go from one extreme to the other: from recession to growth champion. And all of this in less than one year.

The German economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-4.9	2.8	3.5	4.1
Private consumption	-6.1	0.2	4.2	2.8
Investment	-4.0	1.7	4.0	5.3
Government consumption	3.3	3.1	3.5	2.1
Net trade contribution	-2.1	0.3	-0.1	0.5
Headline CPI	0.4	3.1	3.9	2.0
Unemployment rate (%))	3.1	3.4	3.1	3.0
Budget balance as % of GDP	-4.2	-4.5	-6.5	-2.5
Government debt as % of GDP	72.0	72.0	74.0	68.0

Source: ING

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France: Solid rebound and moderate inflation bode well for Macron's re-election

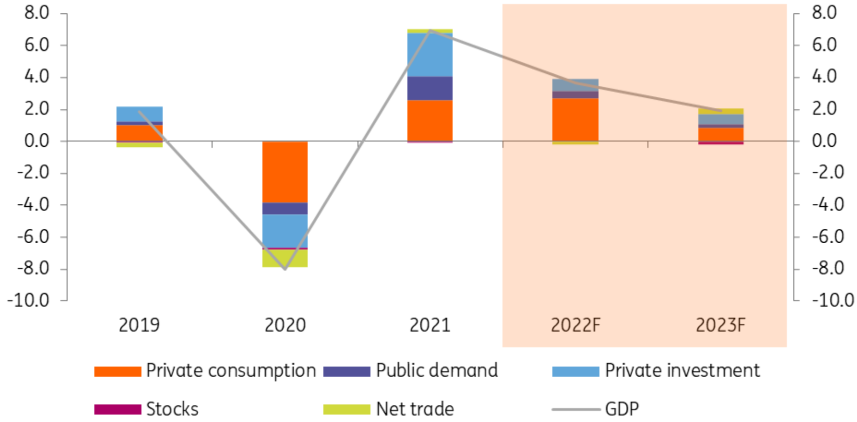
The economic rebound in France was dynamic in 2021, albeit uneven, and should continue in 2022, with inflation remaining more moderate than elsewhere in...

French President Emmanuel Macron was re-elected to second term

A solid but uneven rebound

After two strict lockdowns in 2020 that led to an 8% fall in GDP, 2021 was well-positioned for a rebound. Driven mainly by investment and consumption, the economy grew by 7% over the year, enabling France to return to its pre-crisis level of activity in the third quarter and to exceed it by 0.9% by the end of the year. Household consumption, which was still largely restricted by health measures during the first half of the year, rebounded sharply to its pre-crisis level by the end of the year. Overall, the recovery in 2021 was impressive, but also relatively uneven across sectors. While the production of services was, at the end of 2021, well above its pre-crisis level (+3.1%), the production of goods is far from having caught up. At the end of 2021, industrial production was 5.9% below its pre-crisis level and, notably, below the level at the end of 2020. This is due to the generally unfavourable international backdrop, with supply chains severely disrupted, but also due to the specific nature of French industry, which is largely focused on transport equipment - an area that was severely impacted by the health restrictions, with production at the end of 2021 still

19.2% below its pre-crisis level.



Source: INSEE, Forecasts ING Economic Research

Positive outlook, but uncertainty linked to inflation and the presidential elections

For 2022, the outlook is generally positive. Although the first quarter will probably be weaker due to the significant absenteeism caused by Omicron, the rebound should continue and intensify in the second quarter. Thanks to significant regulation of gas and electricity prices, overall consumer price inflation remains moderate in France compared to neighbouring countries (HICP at 3.3% in January). Consumption is therefore less likely to be impacted by a loss of household purchasing power than in other countries and should remain an important driver for growth. This is especially true in the context of a labour market that is doing very well, with the level of employment at the end of 2021 3.3% higher than at the end of 2019, and 61% of manufacturing companies and 54% of service companies indicating that they are having difficulty recruiting (according to the INSEE survey of January). Higher negotiated wages are expected, which should allow consumption to remain dynamic throughout the year. Industry is also expected to become a driver of economic growth as the difficulties on international production lines begin to ease, allowing it to catch up. We expect GDP growth of around 3.7% for 2022 as a whole and 1.9% for 2023, with inflation above 2% for 2022 as a whole, before declining slightly.

Inflation remains an important risk factor, however, as it could jeopardise the economic recovery if it increases much more than expected, and could lead to significant social tension. Memories of the “yellow vest” crisis are still fresh and fuel prices at the pump have risen sharply. With purchasing power the main concern for French people and presidential elections coming up in April, the government will be forced to monitor the situation very closely and has acted on several occasions to lower the impact of rising energy prices on household purchasing power. The presidential elections, and especially the policy direction of the next president of the Republic, are also an important element of uncertainty for the French economic outlook. Still not a declared candidate, Emmanuel Macron seems to be on his way to a second term as he still dominates all polls with nearly 25% of voting intentions for the first round. The right-wing and far-right candidates are just behind, but none of them really stand out (Valérie Pécresse: 17% of voting intentions; Marine Le Pen: 17% and Éric Zemmour: 14%). The left is largely behind, with four candidates each receiving between 3 and 4% of voting intentions, and Jean-Luc Mélenchon at 9%. Whatever the opponent in the second round, the polls all indicate, at the moment, a victory for Macron. In any case, the next president will have the onerous task of establishing a credible budget after a considerable deterioration in public finances, firstly as a result of the aid put in place during the pandemic, and then as a result of the support measures taken in the face of rising energy prices, which have increased public debt to 114% of GDP in 2021, and the deficit to 7.6%. For the moment, no presidential candidate has said anything about how the issue will be addressed, making budget sustainability a largely absent theme from the campaign.

The French economy in a nutshell

(% YoY)	2020	2021	2022F	2023F
Demand and output				
GDP	-8.0	7.0	3.7	1.9
Private consumption	-7.2	4.8	5.1	1.6
Investment	-8.9	11.6	3.4	2.9
Government spending	-3.2	6.1	1.8	0.9
Net trade contribution (% points of contribution to GDP)	-1.1	0.2	-0.2	0.4
Labour market				
Unemployment rate (%, Eurostat)	8.0	7.9	7.8	7.6
Government finances				
Budget balance as a % of GDP	-9.1	-7.6	-5.3	-4.4
Government debt as a % of GDP	115	114	113	113
Prices				
Inflation (HCPI)	0.5	2.1	2.1	1.7

Source: ING Economic Research

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Article | 8 February 2022 Italy

Italy: Soft start to 2022 on inflation headwinds

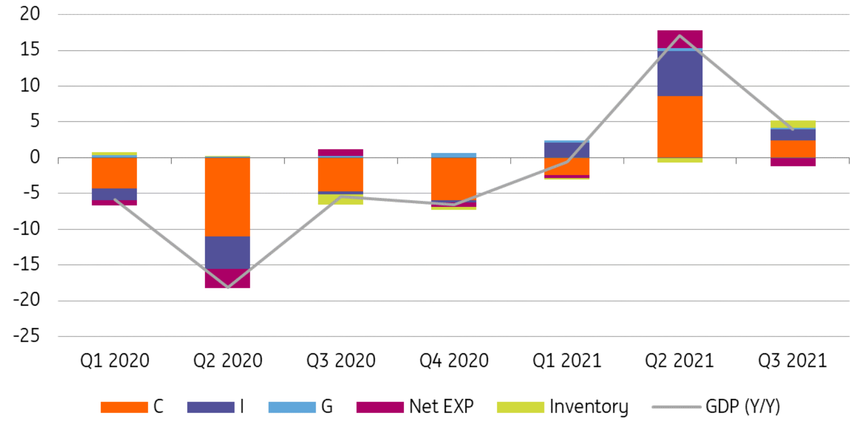
The inflation story will likely be a short-term drag on economic growth and put fiscal policy to the test

Italian President Sergio Mattarella was re-elected for a second term in January

Strong rebound in 2021

Having contracted by 8.9% in 2020, the Italian economy rebounded by 6.5% in 2021, a good result after a soft start to the year. The estimated growth breakdown shows that this was almost fully ascribable to the recovery of private consumption and gross fixed capital formation. No magic wand, but the combined effect of a successful vaccination campaign, of broad-based reopenings which came with it, and generous public resources which helped to keep workers on payrolls and protect small businesses from liquidity shortfalls and bankruptcy.

Domestic demand-driven rebound



Source: Refinitiv Datastream, ING

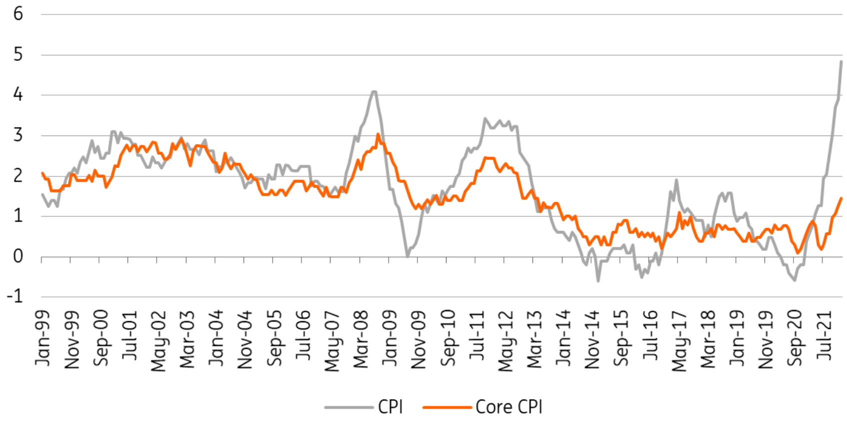
Re-election of Mattarella to help Draghi refocus on the recovery plan over the rest of the legislature

After an almost inevitable slowdown in government activity in January in the run-up to the presidential election, a pressing schedule of targets and reforms foreseen by the Italian recovery plan will likely force an acceleration very soon. Under President Sergio Mattarella's renewed protective umbrella, Prime Minister Mario Draghi should now be in a better position to focus on execution until the end of the legislature, in spring 2023. True, the troubled electoral week opened cracks in the centre-right alliance and a leadership issue within the 5SM movement. However, we believe that in the short term this will not impact the government's stability, as the political price of deserting the alliance and creating a discontinuity in the inflow of EU money would be very high for any party.

Fewer restrictions ahead, but inflation headwinds will likely slow down consumption in 1Q22

Tentative signs of regression in the Omicron wave have recently pushed the Italian government to announce an imminent reduction of restrictions, which is clearly good news for developments in the consumption of services. However, the positive impact on growth of a new wave of reopenings will have to face the strengthening headwind coming from inflation and its impact on real disposable incomes and business profitability. The acceleration of headline inflation to 4.8% year-on-year in January, mainly driven by the energy component, reflects Italy's vulnerability to gas price developments. To combat this and help low-income households and small businesses, the government has introduced extraordinary measures in the form of VAT cuts and bonuses on regulated energy bills. These notwithstanding, the average household is facing sharp price rises in energy bills. With wage growth at 1% year-on-year, the decline in January consumer confidence is hardly surprising and a deceleration in private consumption in 1Q22 seems highly likely.

Inflation spike still mainly an energy story



Source: Refinitiv Datastream

High energy prices could also affect production in early 2022

Businesses are not immune, either. Manufacturers, which are still dealing with persistent if tentatively diminishing supply chain disruptions, are also confronted with high energy cost pressures and often remain hesitant to pass them through to consumers. Reports of possible temporary production stops among heavy energy users signal that industrial production could have a soft start in 2022.

Design of fiscal compensation a first test for transition to "normal" fiscal discipline

The scope of the energy inflation issue has indirectly entered the political debate, with many parties already calling for quick parliamentary approval for a substantial pre-emptive extra deficit to get fiscal ammunition for more compensating measures should the inflationary wave last beyond 1Q22. For the time being, the government is banking on the fact that funds unspent in 2021 will likely be enough to finance extraordinary energy-related outlays over 1Q22. Should inflationary pressures persist in 2Q22, political requests for more spending would likely grow louder, and finance minister Daniele Franco would be forced to tread a thin line; on one hand trying to maintain political support, on the other, needing to migrate the country back towards a new normal of limited resources (call it fiscal discipline), at a time when negotiations on the reform of the Stability and Growth pact will likely be progressing, and the tapering of ECB net purchases will already be unfolding. The ongoing widening of the BTP-Bund spread suggests that markets are already watching closely.

	2022	2023F	2024F	2025F
GDP	3.9	0.7	0.4	1.0
Private consumption	5.0	1.5	0.5	1.0
Investment	10.0	1.5	-0.4	1.2
Government consumption	0.7	0.8	0.1	0.4
Net trade contribution	-0.5	-0.4	-0.5	0.3
Headline CPI	8.7	6.0	2.2	2.0
Unemployment rate (%))	8.1	7.7	7.8	7.7
Budget balance as % of GDP	-8.0	-5.4	-4.5	-3.7
Government debt as % of GDP	141.7	140.2	141.3	141.3

Source: Refinitiv Datastream, all forecasts ING estimates

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Spain: Tourism and employment boom puts economy back on track

The first quarter of 2022 will be impacted by the Omicron wave, but from the second quarter onwards we expect the economy to grow faster again. A strong...

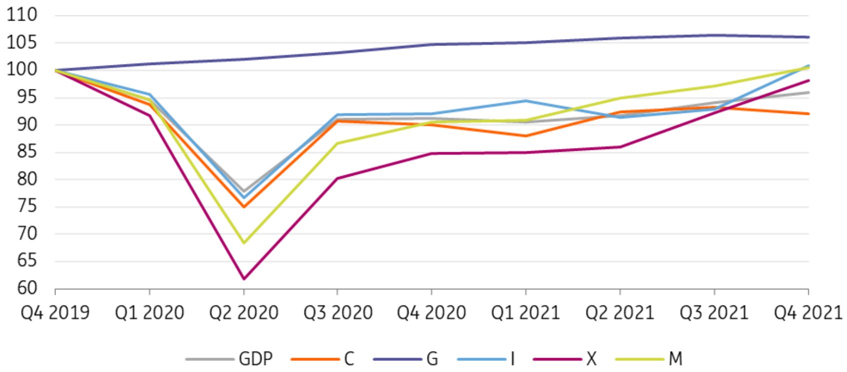
Spain's tourism sector has not yet fully recovered from the Covid-19 pandemic, but this gives more potential to support growth in the years to come

Stronger growth from 2Q onwards

The Spanish economy ended 2021 on a strong note. GDP growth came in at 2% quarter-on-quarter, which was higher than expectations. Due to the Covid-19 Omicron wave consumption contracted, but investment and exports grew sharply. The economy is now about 4% smaller than pre-pandemic levels. This is in contrast to the eurozone as a whole, which reached its pre-pandemic level in 4Q21.

Survey data, however, points to a weakening in the first quarter of this year caused by Omicron. But from the second quarter onwards we expect the economy to grow faster again. The main reasons for this are a vibrant labour market, a boost to public investment, and a continued recovery of the tourism sector. High inflation, however, is currently a threat, even though we think it will come down over the year.

Evolution of GDP and components during the pandemic (4Q 2019 = 100)

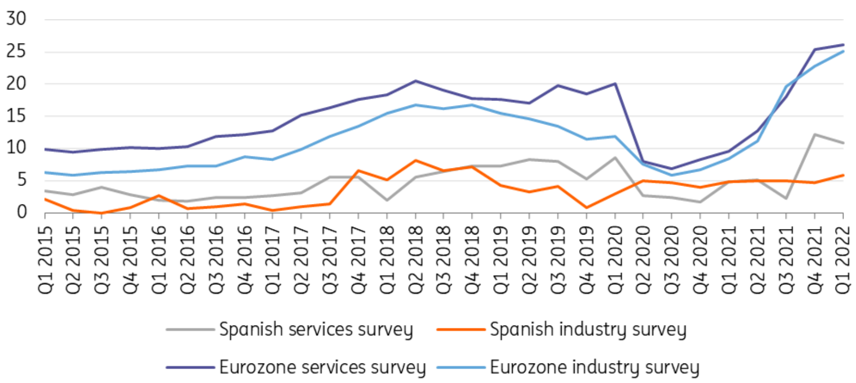


Source: Refinitiv

A very strong labour market will support consumption

Historically, the negative impact of a recession on the Spanish labour market is quite extreme and long-lasting. But the impact of the pandemic is already digested. Indeed, there are currently more people registered with the social security system and fewer people are jobless than before the pandemic. The unemployment rate was 13.3% in the final quarter of 2021, which is lower than before the pandemic. Looking ahead, it is likely that the unemployment rate will continue to fall. Demand remains strong as industrial companies indicate that their order books are richly filled, even more so than before the pandemic. And the number of businesses that report labour shortages is still limited, certainly compared to the eurozone.

Figure 2: Spanish companies are less labour strapped (% of businesses saying that labour limits their production)



Source: Refinitiv

Structural problems in the labour market are still with us

All this is obviously good news for short-term economic activity, but that does not mean the structural problems in the labour market are history. Indeed, the Spanish unemployment rate is still almost double the rate of the eurozone, youth unemployment is very high, and almost one in four Spanish workers is on a temporary contract.

The latest labour market reform, which tweaks the 2012 measures and focuses on limiting the use of temporary contracts, caused a lot of discussion on the political front. It is backed by businesses and unions, but initially it did not have sufficient support in parliament. Surprisingly, it did pass recently… by accident. This could obviously cause some political tension.

Rise in public investment will support growth

The labour reform is also important for short-to-medium term activity as it would help to secure new NextGenerationEU (NGEU) funds which should boost public investment. The Spanish government wants to frontload the EU money and spend 77% of the €70bn in grants (about 4.5% of 2021 GDP) over the period 2021-23. The next instalment of €14bn should be requested before April. Even though we think this rate of absorption is very ambitious, the NGEU will still have a positive impact on growth in 2022 and 2023.

Another issue that will support public investment is the budget for 2022, the largest in Spanish history. It was approved at the end of last year, which lowered political uncertainty and includes €40bn of investments (including NGEU funds).

Tourism sector will further recover

During the first quarter of this year, the tourism sector will still be affected by the Omicron wave, but we think that from the second quarter onwards the sector will be able to continue its recovery. In 2021 the tourism sector was able to recuperate but less than expected due to travel restrictions and new Covid waves. The number of international tourists grew from about 19 million in 2020 to about 31 million in 2021, but this is still about 52 million (!) less than in 2019. Since this sector has not yet fully recovered, this of course gives more potential to support growth in the years to come.

Inflation should come down during 2022

As for the whole of Europe, rising inflation is a threat to the Spanish economy. Headline inflation was about 0% at the beginning of 2021, but in January 2022 it equalled about 6%. Core inflation started to rise in the middle of 2021 from about 0.2% to 2.4% in January 2022. The biggest contributor to the rise was higher energy prices, and this item has a larger weight in Spain than the eurozone as a whole. But the sharp rise of core inflation warrants caution. Indeed, higher energy prices can feed into other consumer prices and on top of that more and more companies are saying that they will increase their selling prices. We nevertheless expect that inflation will come down during 2022 as we do not expect energy prices to rise as much in 2022 as they did in 2021. They might even come down. However, due to second-round effects, we expect about 2.5% headline inflation at the end of 2022, which is higher than pre-pandemic levels of about 1.0%.

Conclusion

All in all, the economic outlook is good for Spain. We expect the economy to grow by about 5.0% in 2022, matching the 5.0% growth in 2021. For 2023 we expect about 3% growth. In this scenario the Spanish economy would reach its pre-pandemic level in the first half of 2023. Indeed, the firm labour market, a push of public investment, a further recovery of the tourism sector and declining inflation should all help to push the economy further.

The Spanish economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-10.8	5.0	5.0	3.0
Private Consumption	-12.0	4.6	5.0	3.2
Investment	-11.4	6.6	9.0	4.4
Government Consumption	3.3	3.0	1.6	1.4
Net trade contribution	-1.7	0.5	0.7	0.2
Headline CPI	-0.3	3.0	4.0	2.2
Unemployment rate (%)	15.6	14.8	12.0	9.5
Budget balance in % of GDP	-11.0	-8.2	-4.7	-3.0
Government debt in % of GDP	120	120	115	113

Source: Refinitiv Datastream, all forecasts ING estimates

Article | 10 February 2022

Netherlands: Economic growth relies on the absence of new lockdowns

Now that the lockdown has been eased, consumption is rebounding, allowing the Dutch economy to continue its expansion. GDP is forecast to grow by 3.3% in...

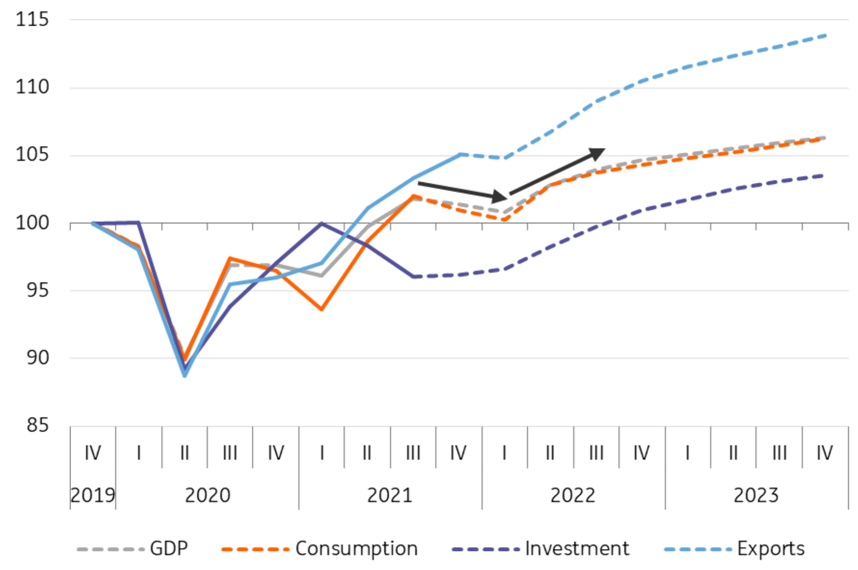
Last month the Dutch government began to ease its Covid-19 restrictions, which were among the toughest in Europe

Fall in consumer spending has not stopped economic expansion

On 26 January 2022, shop opening hours were extended until 10pm, while bars and restaurants, cultural and sports venues were reopened again and events allowed. This heralded the end of the Netherlands' strict lockdown, in most cases still with distance, capacity and time restrictions. This recent lockdown caused a substantial fall in consumer spending, as observed in ING transaction data. First estimates suggest that the fall is half as large as during the lockdown of January 2021, while spending rebounded strongly at the end of January. This, combined with high energy and fuel inflation (+58% year-on-year in January 2022), implies decreasing household consumption in 4Q21 and 1Q22. As exports and investment are most likely less affected by the domestic surge in the pandemic, our gross domestic product (GDP) growth forecasts are only mildly negative (-0.4% and -0.6% respectively).

Consumption-driven setback until 1Q22; solid progress thereafter

Expenditures* as index where fourth quarter of 2019 = 100



Source: Macrobond, forecasts ING Research as of 4Q21
*seasonally adjusted and in constant prices

In our base case with GDP growth of 3.3% for 2022, we assume the absence of new domestic lockdowns. This is a downward risk: uncertainty surrounding the pandemic is still significant. As available monthly data on industrial production, construction, retail sales and especially exports for the end of 2021 seems decent, a surprise to the upside can also not be fully ruled out. Overall, the outlook for the Dutch economy is uncertain but positive for the years ahead, not least because of the additional demand push of the policy measures of the coalition agreement.

See here for our initial take on the coalition agreement of the Rutte IV government.

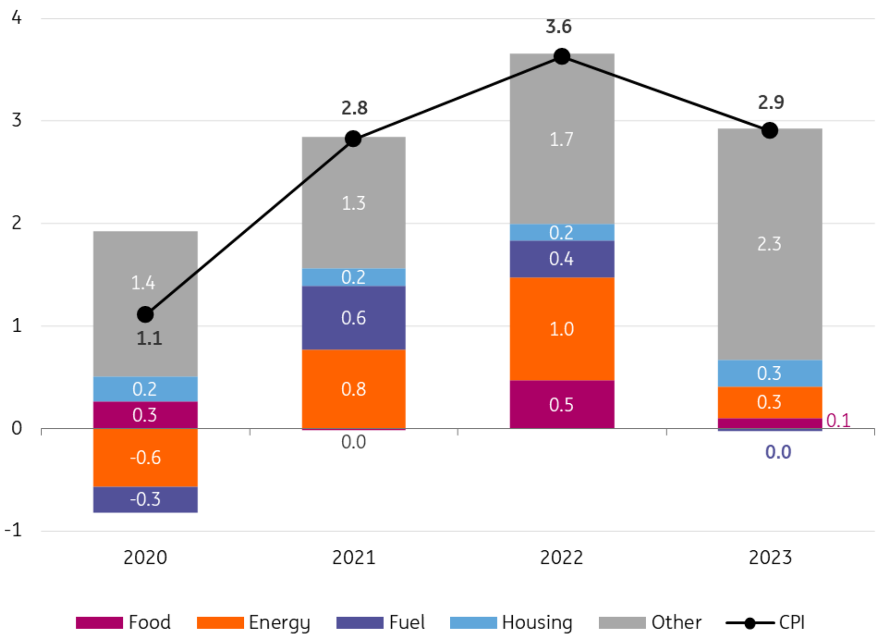
Inflation substantial on energy and fuel in 2022, but also in 2023 due to policy changes

Inflation in the Netherlands is among the highest in the eurozone (7.6% year-on-year harmonised index of consumer prices change in January). In contrast to the US, wage-cost-push inflation is not yet part of the story. This is despite the fact that the Dutch labour market is very tight, with an unemployment rate of 3.8% in December (according to a revised surveying method of Statistics Netherlands).

Two-thirds of the price rise is driven by energy and fuel prices. Also, non-energy industrial goods and food are increasingly contributing to inflation on the back of elevated transportation costs, supply chain disruptions, energy cost inflation and higher world food prices. Volatile and hard-to-predict forward markets suggest that energy prices might stay high at least until the end of winter and fall thereafter, but will not necessarily return to pre-pandemic levels.

Inflation elevated both in 2022 and 2023

Change in harmonised index of consumer prices year-on-year in % and contributions in %-points



Source: Macrobond, forecasts as of 2022 by ING Research

As energy inflation falls in our forecasts, the overall inflation rate will return to more normal levels (close to or below 2%) by the end of 2022. Nevertheless, we forecast inflation to stay close to 3% for the year 2023, following approximately 3.5% in 2022. This is due to specific policy changes in the Netherlands. Some stem from the ending of Covid-inspired support policies, while others result from a new coalition agreement:

- College tuition fees were halved, and these will be normalised in September 2022, which mostly affects 2023 inflation.
- Social housing corporation rents face a nominal freeze until 1 July 2022, which mostly affects 2023 inflation. Additionally, social housing rents will become more income-dependent, depressing rents for low income but raising them for higher incomes. We forecast that the net effect is more or less a normalisation of social rent increases.
- The normally liberalised rent sector currently faces temporary limited rent increase regulation (past inflation +1%-point) until 1 July 2024, which implies higher inflation in 2023 and 2024.
- The previous government lowered the energy tax (on gas and electricity) temporarily for 2022. The reversal in 2023 will have an upward effect on inflation for 2023. The new government plans to structurally lower the energy tax as of 2023, but this impact is much smaller.
- The new coalition will gradually increase the excise tax on a pack of cigarettes to €10.
- The new coalition will increase the excise tax on non-alcoholic drinks.

On top of the policy changes that directly affect inflation figures, the fiscal plans of the new government are strongly expansionary, generating upward price and wage pressure for the years to come. All in all, a positive outlook with the usual Covid uncertainty and unusually high inflation.

See here for the estimated economic implications of the intended policies of the Rutte IV government.

The Dutch economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-3.8	4.4	3.3	2.6
Private consumption	-6.6	3.2	4.9	2.8
Investment	-4.1	2.7	1.2	3.9
Government consumption	1.0	3.9	2.5	2.5
Net trade contribution (%-point)	0.1	1.8	0.2	0.0
Headline HICP	1.1	2.8	3.5	2.9
Unemployment rate (%)*	4.9	4.2	4.0	3.9
Budget balance (% of GDP)	-4.2	-5.1	-3.4	-1.8
Government debt (% of GDP)	54.4	57.1	57.0	56.2

Source: Macrobond, all forecasts as of 2021 ING Research estimates. *In line with new estimates based on the new survey method of Statistics Netherlands, which should have made the Dutch statistic more comparable to those of elsewhere in the EU.

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Article | 10 February 2022

Eurozone Quarterly | Belgium

Belgium: Same challenges, but more serious

Belgium was one of the countries most affected by the pandemic and is facing two other problems more than others: inflation and (public) debt

The market square in the centre of Bruges

Decent recovery

At first glance, the Belgian economy is doing much better after the major shock of 2020. After two quarters of very dynamic growth (respectively +1.7% and +2.0% quarter-on-quarter non-annualised in the second and third quarters of last year), the Belgian economy ended the year with respectable growth of 0.5% (which is close to potential growth). It should be noted that the last quarter of 2021 was marked by new restrictions on activity, mainly in the hospitality sector, due to the pandemic. Supply problems are also affecting the construction and industrial sectors in many countries. However, according to a preliminary estimate, the Belgian manufacturing sector grew strongly in the last quarter, by 3.3%. This is probably linked to the activity of the pharmaceutical sector, as some Covid vaccines are produced at the Pfizer site in Belgium.

Employment has been extremely level thanks to support measures

GDP and employment index (2019 Q4 = 100)

Source: National Bank of Belgium, Refinitiv Datastream, ING
GDP and Employment index (2019 Q4 = 100)

Solid labour market

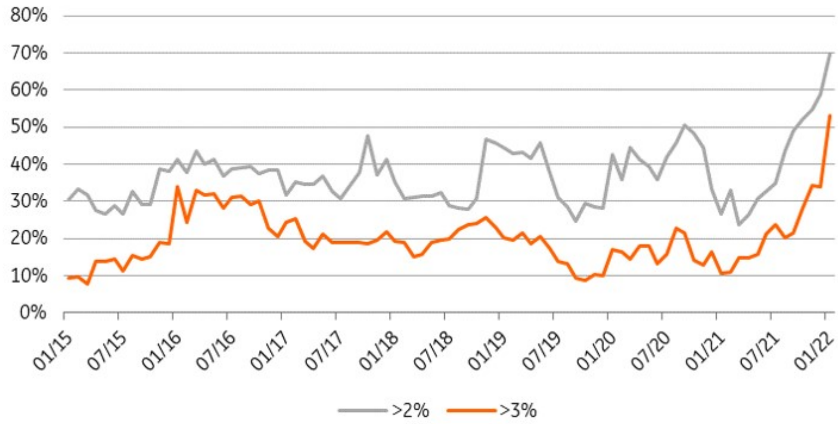
In terms of employment, most indicators remain in the green: total employment is already above its pre-crisis level and the unemployment rate has fallen to 5.8%. However, it should be noted that almost 200,000 workers were still using Covid temporary unemployment in December 2021, which still represents 45,000 full-time employees or 0.9% of total employment. Some sectors, such as travel agencies or event management, are particularly affected. The end of the support measures (2Q 2022 a priori) could therefore cause a shock to the labour market if the sectors in question still face a lack of demand. Nevertheless, there are still plenty of jobs available and the lack of labour remains, together with supply problems, the main constraint to business activity. Consequently, the macroeconomic damage in terms of employment should remain limited.

Given the international developments (better control of the pandemic, improvement in supply problems in the second half of the year, etc) we think that the recovery should continue this year, despite a turbulent start.

Broad-based inflation

However, in a recent speech, IMF director Kristalina Georgieva indicated that the world economy faces three challenges in 2022: Covid-19, inflation and a mountain of debt. This particularly applies to Belgium. Leaving the Covid issue aside, we have to admit that inflation in Belgium is at a recent high: 7.6% in January according to the national definition, and even 8.5% based on the HICP. This very high figure is obviously linked to the prices of natural gas (up 154% over one year) and electricity (+71%), but it should be pointed out that 70% of the goods and services in the price index have already seen an inflation rate of more than 2% and more than 50% of the index has an inflation rate of more than 3%. So it is no longer just an energy problem. Moreover, any inflationary surge is not without consequence in Belgium because of the automatic wage indexation mechanism. While the European Central Bank is wondering about a possible future rise in wages in the eurozone, wages will probably rise by more than 4.5% in the private sector this year just because of this mechanism. Belgium will probably be one of the countries where the risk of a wage-price spiral is the highest.

Share of consumer price index with inflation above X%



Source: Statbel, ING

A looming problem

The other concern relates to public finances and the evolution of debt. According to forecasts from the European Commission, Belgium will be the worst performer in the eurozone in terms of its primary surplus/deficit over the period 2022-2023. We agree with this forecast, in the absence of any new policy. The crisis has created large deficits, but no one in government (be it at the federal or the regional level in Belgium) wants to take responsibility for putting the brakes on public spending. High inflation, which also inflates GDP, should slow down debt dynamics this year. But afterwards, the high level of debt in the context of an uncontrolled deficit could become the number one issue for authorities in 2023. Everything will obviously depend on the efforts required by the European fiscal rules (suspended since the Covid crisis). If a major effort has to be made, it will be politically difficult, with one year to go before the elections (2024), to make major cuts in spending, despite the fact that here, too, Belgium is leading the European pack. An increase in taxation, therefore, seems unavoidable. The problem of public finances could, from 2023 onwards, become a brake on economic growth.

The Belgian economy in a nutshell (%YoY)

	2019	2020	2021F	2022F	2023F
GDP	2.1	-5.7	6.1	3.0	1.9
Private consumption	1.8	-8.2	6.0	4.0	1.6
Investment	4.5	-6.2	10.0	1.4	1.9
Government consumption	1.7	0.2	4.2	4.1	2.0
Net trade contribution	0.2	-0.3	0.5	-0.7	-0.1
Headline CPI	1.4	0.7	2.4	4.8	1.8
Unemployment rate	5.4	5.6	6.3	5.8	5.6
Budget balance as % of GDP	-1.9	-9.4	-6.9	-5.5	-4.9
Government debt as % of GDP	98.1	114.1	111.4	109.3	110.5

Source: Thomson Reuters. all forecasts ING estimates. unemployment rates according to ILO definition

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Austria: Compulsory vaccination to supercharge the economy

2021 ended on a turbulent note for Austria, both economically and politically. Now, compulsory vaccination might be the game changer and with the return...

Source: Shutterstock

The Austrian economy was on its way back to pre-crisis levels just before the fourth Covid-wave hit the economy. On the back of a full lockdown, the alpine country's economy contracted by 2.2% quarter-on-quarter in the fourth quarter of 2021. In the full year of 2021, the Austrian economy grew by 4.9%.

By the end of 2021, new infections were on the rise again across the eurozone, and Austria was no exception. In fact, Austria was the first country in the region to tighten containment measures and to bring compulsory vaccination into play to help control the pandemic. A lockdown for both the vaccinated and unvaccinated population was introduced in November, hitting the economic performance during the last three months of 2021.

Fortunately, looking ahead, it can only get better. The implementation of compulsory vaccination on 4 February will be followed by a far-reaching easing of restrictions - the closing time in hospitality will be shifted from 10 pm to midnight, from 12 February onwards the 2G obligation will no longer apply in retail shops and a week later, hotels and restaurants will again be subject to the 3G instead of the 2G rule. This should provide a tailwind for both private consumption and tourism. Industry is also in a relatively good position. As shown from Statistic Austria's industrial production index, despite ongoing supply chain disruptions, industrial production increased in October and

November.

However, persistently high inflation remains a risk. For the entire year 2021, inflation came in at 2.8% and in January this year headline inflation accelerated to 4.6% YoY, the highest inflation reading since the beginning of the timeline in 1990. And inflationary pressures are unlikely to abate any time soon as the introduction of a carbon tax (in July) is likely to push inflation higher in the second half of 2022. However, despite high inflation, household net income should rise on the back of both the tax reform that came into force on 1 January and expected wage increases in 2022 and 2023. We expect the Austrian economy to grow by 3.9% in 2022.

The tax reform, which also includes a reduction in corporate income tax, shows that the government is trying to lower the public debt ratio via higher growth rather than via higher revenues. The government debt ratio is estimated to drop from 84% of GDP in 2021 to 80% in 2022.

The seasonally-adjusted unemployment rate (Eurostat) stood at 5.3% recently, which is 0.8 percentage points above pre-crisis levels. Unemployment has recently been declining and until the fourth lockdown, short-time work was also on the decline. This brings the structural problems in the labour market into focus for the post-pandemic period, especially due to the ongoing shortage of skilled workers. A relatively high number of long-term unemployed, as well as older unemployed, who are having trouble finding their way back into employment, pose a challenge to the labour market. The large share of female employees working part-time also continues to be a structural problem. Thus, the Austrian labour market will need strong reforms post-pandemic, but for the moment, a further stabilisation and reduction of unemployment can be expected.

Compulsory vaccination will be helium to the economy, as it should boost both private consumption and tourism activity, although it could take until the second quarter for the effect to fully materialise. Looking ahead, the Austrian economy is expected to rise strongly and hopefully with plenty of strength to implement postponed reforms after the latest series of pandemic and political challenges.

The Austrian economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-6.7	4.9	3.9	2.2
Private Consumption	-8.5	3.6	5.0	2.0
Investment	-5.2	7.5	4.0	2.0
Government Consumption	-0.5	3.9	0.5	0.3
Net trade contribution	0.8	0.5	0.4	0.6
Headline CPI	1.4	2.8	3.1	2.1
Unemployment rate (%)	6.1	6.1	4.9	4.5
Budget balance in % of GDP	-8.3	-6.0	-3.0	-1.5
Government debt in % of GDP	83.2	84.0	79.5	77.4

Source: Thomson Reuters, all forecasts ING estimates

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Greece: What next after the V-shaped rebound?

After a very strong consumption-driven rebound in 2021, the Greek economy will move towards a new normal, where investment will gain a more visible role,...

Tourism was a significant driver of growth in the Greek economy in the second half of 2021

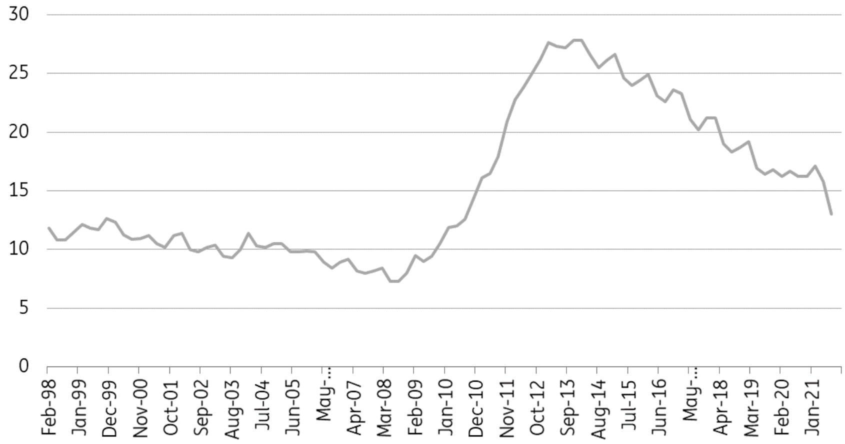
An almost V-shaped rebound in 2021

The rebound of the Greek economy after the Covid-19 slump has been surprisingly strong. After falling 8.8% in 2020, the economy posted substantial gains in every quarter in 2021, resembling a V-shaped profile. A softer 4Q21 would still leave average 2021 growth close to 8%.

Private consumption and summer tourism the main drivers of growth

Such a strong rebound resulted from a combination of factors. Extraordinary public support was effective in propping up the labour market, with employment exceeding pre-Covid levels by the summer and unemployment falling to 13% in 3Q21, the lowest level since 2010. Labour protection allowed consumers to spend part of the savings accumulated during the pandemic, with the most obvious positive effects on durable goods. On the tourism front, the partial lifting of international travel restrictions was reflected in a strong acceleration of inbound tourist flows in 3Q21, which were at the heart of the solid contribution of the exports of services to GDP growth.

Declining unemployment rate supported consumption recovery over 2021



Source: Refinitiv Datastream

Investments, spurred by RRF funds, to gain traction in 2022

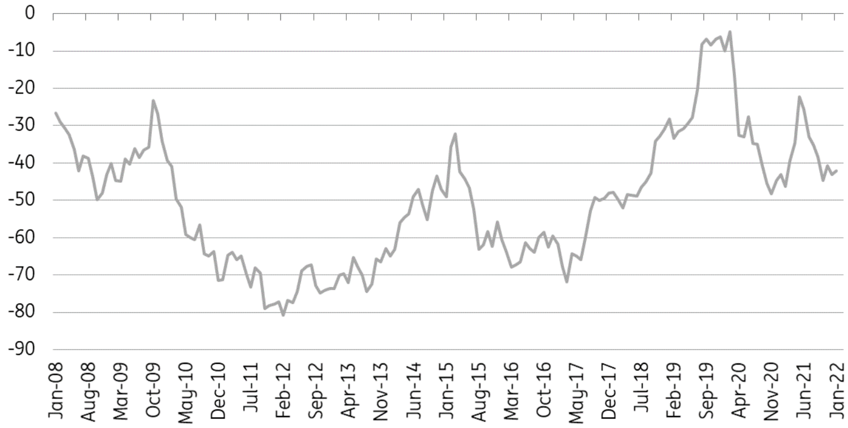
With the phasing out of extraordinary Covid-19 support measures, 2022 should mark a transition towards more balanced growth, with a bigger role for investment. The process should be crucially helped by the inflow of grants and loans from the European Recovery and Resilience Facility (RRF), mostly channelled into the digital and green domains. These should at first propel the public investment component, which had undergone severe cuts over the fiscal adjustments of the last decade, but also activate new private investment.

As far as private investment is concerned, the pull coming from RRF funds might not necessarily be smooth though because the structure of the Greek economy, still dominated by small firms, might not represent the most fertile environment for substantial investment flows. Still, the improved financial position of non-financial corporations and resilient business confidence indicators justify some optimism.

Impact of inflation on consumption the biggest risk for 2022

The biggest risk to Greek growth in 2022 is posed by the uncertain impact of rapidly-rising inflation on private consumption. In Greece, the deflationary impact of Covid-19 had kept annual inflation in negative territory through to May 2021, supporting real disposable income and, ultimately, private consumption. Since then inflation has crept up, reaching 5.1% in December 2021, driven by the energy components but also by food and beverages, and used and new cars. We expect that good labour market conditions will weather the shock, but softer consumption looks very likely at least over 1Q22.

Consumer confidence might soon reflect inflation impact on household disposable income



Source: Refinitiv Datastream

Fiscal policy is getting neutral, as temporary support measures are suspended

The strong growth performance over 2021 and the follow-up in 2022 should allow for a substantial improvement in public accounts. The Greek government has made a target in the 2022 budget of a reduction in the primary deficit to 1.2% of GDP, from an estimated 7.3% in 2021. This is expected to come from improvements in tax revenues and by the phasing out of the temporary fiscal stimulus, with a neutral fiscal stance confirmed by a stable projection for the cyclically adjusted primary deficit. This should allow a further decline in the debt/GDP ratio well below the 200% threshold.

The Greek economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-8.8	7.5	3.4	2.9
Private consumption	-7.1	5.4	3.3	2.2
Investment	0.4	16.5	7.7	5.3
Government consumption	2.6	4.6	1.1	1.1
Net trade contribution	-4.2	0.4	0.9	0.8
Headline CPI	-1.3	0.6	3.3	1.7
Budget balance as a % of GDP	-9.7	-9.2	-4.5	-2.1
Government debt as a % of GDP	205.6	200	195	191.2

Source: Refinitiv Datastream, all forecasts ING estimates

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Portugal: Political stability to support economic growth in 2022

We expect the Portuguese economy to continue to grow at a firm rate in 2022. A strong labour market, lower political uncertainty, and a fiscal boost from...

Portugal’s left-wing Socialists, lead by Antonio Costa, surprised with a majority win in January's snap election

We see economic growth rebounding in 2022

The latest gross domestic product report showed that the Portuguese economy grew by 4.9% in 2021, the highest growth figure since 1990. The economy was able to grow relatively well in the final quarter of the year (1.6% quarter-on-quarter), which implies that the economy is now only 1.5% smaller compared to pre-pandemic levels.

For the first quarter of 2022, we expect a slowdown due to the Omicron wave, but thereafter we expect growth to pick up. Activity should reach its pre-pandemic level in the second half of 2022. For 2022 as a whole, we expect 5.5% economic growth.

The strong labour market should support activity. The unemployment rate was equal to 5.9% last December, which is lower than before the pandemic. As we expect demand to remain elevated from the second quarter onwards, and the number of businesses that report labour shortages is currently limited, we expect the unemployment rate to fall further.

Political uncertainty is now lower

Political uncertainty dropped significantly at the beginning of the year. The previous government fell in October 2021 because radical left-wing parties did not support the proposed 2022 budget. Radical left-wing parties wanted to alter the labour law and increase social spending. During the snap elections held in January, however, the Socialist Party unexpectedly won a majority in parliament. This will smooth the approval of the original budget.

It is likely that the Socialist government remains fiscally prudent, even though an important part of the budget will likely invest in the national health service and increase the minimum wage. Increasing the minimum wage in times of higher inflation could pose problems for companies.

The reduced political uncertainty, together with the stronger labour market, might also make consumers more confident which in turn could lower precautionary savings. Currently, the savings ratio is 11%, which is about four percentage points higher than before the pandemic.

A more stable majority will also help secure funds from the Next Generation EU fund. Portugal should receive €16.6bn (about 8% of 2021 GDP) over the next three years. This should boost the current low levels of public investment in Portugal.

All in all, the outlook is positive for the Portuguese economy. A strong labour market coupled with lower political uncertainty and a fiscal boost from Europe will support activity. For 2022 and 2023, respectively, we expect 5.5% and 2.5% economic growth.

The Portuguese economy in a nutshell (%YoY)

	2020	2021F	2022F	2023F
GDP	-8.4	4.7	5.5	2.5
Private consumption	-7.3	5.2	5.2	2.5
Investment	-5.7	6.0	3.0	3.3
Government consumption	0.4	4.8	2.9	1.3
Net trade contribution	-2.3	-0.9	0.8	0
Headline CPI	-0.1	0.9	2.5	2.0
Unemployment rate (%)	7.1	6.6	6.0	5.5
Budget balance as a % of GDP	-5.8	-4.6	-3.4	-3.0
Government debt as a % of GDP	135	133	126	125

Source: Refinitiv, all forecasts ING estimates

Ireland’s economic recovery is not as strong as data suggests

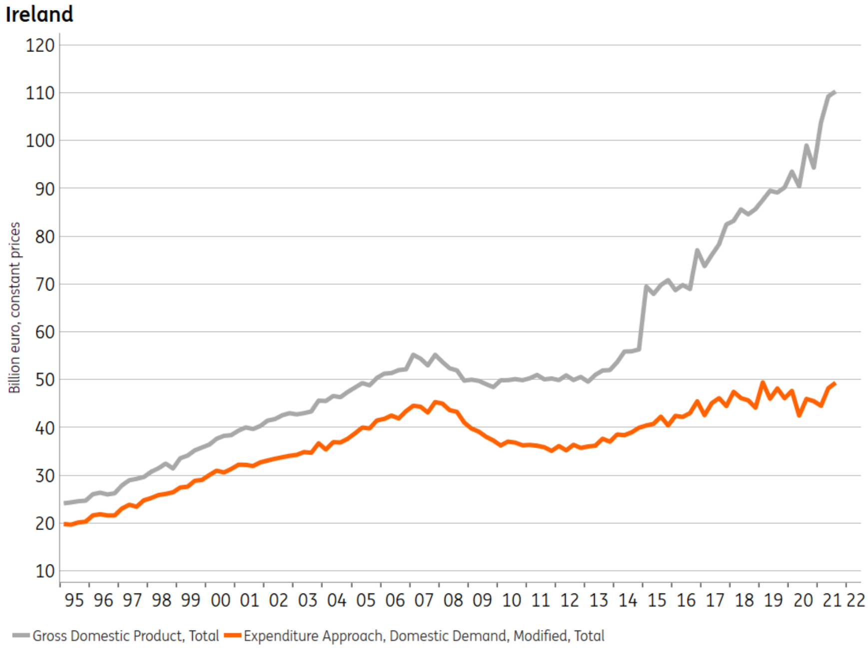
Ireland's GDP figure inflates its economic performance, but underlying data reveals a healthy recovery that shouldn’t be by a reduction in asset...

How is the Irish economy doing? Well, not as great as GDP suggests, but not bad either

Ireland leads the eurozone on economic growth... or does it?

It’s an all too familiar sight at this point, Ireland leading the eurozone in terms of economic growth. Extreme growth rates have been dominated by multinational activity for some time now, resulting in overstated activity compared to actual economic performance of the country, which is why the Irish Central Statistics Office looks at an alternative measure of economic activity: modified domestic demand. As Ireland is a competitive market for exports, there is more omitted from this activity figure than an economist would like to see, but it is a start to get a better sense of what is actually happening in the Irish economy.

As chart one shows, modified domestic demand and gross domestic product (GDP) have become increasingly out of whack. GDP growth has seen more extreme swings in recent years, which has increasingly impaired the view on the Irish economy, but the swings have become so large that it also increasingly muddies the statistics on the entire eurozone. In some quarters, it now has a sizable impact on quarterly GDP numbers and especially on investment figures. Given that the international organisations reporting activity in Ireland often operate well beyond the eurozone, this means that eurozone figures are increasingly distorted as well and numbers should be interpreted with more care than a few years ago.



Source: CSO, ING Research

Ireland's economy is also facing the impact of Brexit

So how is the Irish economy doing then? Well, not as great as the GDP suggests of course, but not bad either. Modified domestic demand is almost back to pre-pandemic levels and the labour market has been recovering quickly. The alternative measure of unemployment including people furloughed has been coming down rapidly and stands just marginally above the regular unemployment rate. Both have recovered quickly to close to pre-pandemic levels. Consumption is also almost there, although the economy has lost momentum due to the new restrictions combating the latest wave of the coronavirus.

Besides new restrictions, Ireland is also facing the impact of Brexit on trade. The impact is hard to judge given all of the pandemic effects playing a role here, but it does look like exports to the UK have been recovering after a rough start to the UK's formal EU exit. Overall, the Irish economy is set to recover swiftly once restrictions are lifted again as the economy still shows strong underlying performance.

Public finances are also doing better than expected and the deficit is shrinking rapidly. The budget balance is expected to drop below -2% this year, well within the European Commission's target of -3% even though the emergency clause on the stability and growth pact is still active. With government debt set to drop below 60% again as well this year, Ireland has little to fear from the ECB tapering asset purchases at the moment. Yields have been on the rise, but are still below 70 basis points at the moment, a confirmation that markets do not see Ireland as a country among the first at risk of problems as the ECB winds down quantitative easing.

Irish economy in a nutshell

IRELAND

	2020	2021F	2022F	2023F
GDP (%)	5.8	15.2	4.7	2.1
Private consumption (%)	-10.4	7.2	6.8	3.1
Investment (%)	-23.5	-31.2	14.1	5.1
Government consumption (%)	9.4	4.4	0.1	0
Net trade contribution (%)	21.4	25.6	2.5	-0.5
Headline CPI (%)	-0.5	2.5	3.6	1.9

Source: Macrobond, ING estimates

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Finland’s recovery on par with Nordic neighbours

The Finnish economy has recovered quickly from the crisis, but growth is muted as rebound effects fade and shortages bite

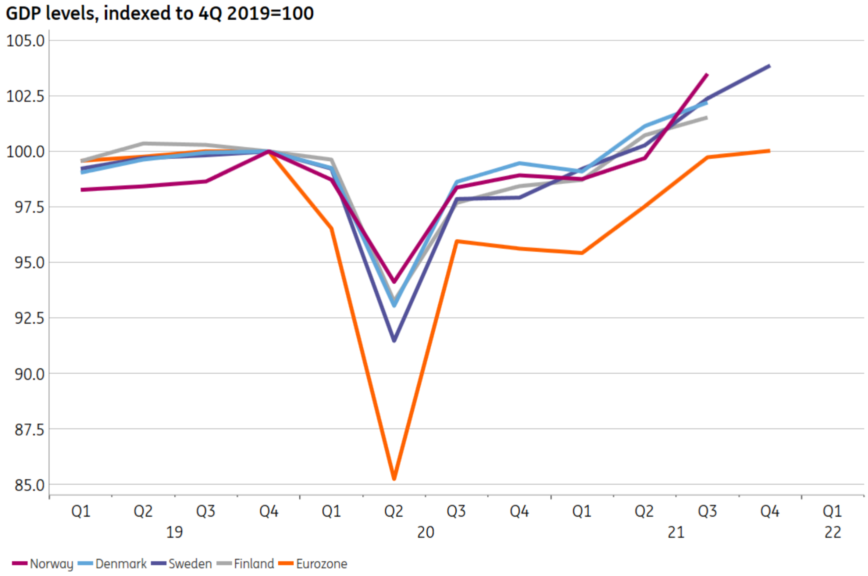
Like most of Europe, Finland has managed to limit the scarring impact from the pandemic

A quick rebound with limited further potential

Finland has maintained its position as one of the eurozone countries that limited economic losses from Covid-19 most successfully. The economy has already surpassed pre-pandemic levels of economic activity and is set for another year of decent growth in 2022. With economic activity already closer to trend than other countries, don’t expect Finnish gross domestic product (GDP) growth to still show sizable rebound effects. We expect GDP to come in at just 2.5% growth for the year.

Like most of Europe, Finland has managed to limit the scarring impact from the pandemic and has done so quite efficiently when looking at government spending. The labour market saw a hit to unemployment in May 2020, but has since seen the rate drop steadily to 7%, marginally above the 6.7% seen prior to the pandemic. The labour market is showing significant signs of tightness as more businesses than ever in both the service sector and in industry now report labour as a factor hindering their business. This is set to translate to higher wage growth, for which the first signs are there. Wage growth at above 5% seems significantly influenced by compositional effects in the labour force, meaning that these data have to be taken with a pinch of salt.

Finland has recovered well ahead of other eurozone economies, but in line with rest of the Nordics



Source: Macrobond, ING estimates

Effective stimulus set to fade

Nevertheless, private consumption is recovering steadily and is just 1% below pre-pandemic levels. Exports and imports have yet to recover as well, while investments saw a tick down in the third quarter but had been above par already before. The main component of GDP that has led Finland out of the recovery has of course been government spending, which is about 4% above pre-crisis levels. Yet, Finland did not have a particularly expensive crisis either from a government spending perspective. The additional stimulus over the past years has been on the low-end compared to other advanced markets, though packages were slightly bigger than in Sweden and Denmark.

Government debt has risen by about 10 percentage points since the start of the pandemic and is set to stabilise around 70% of GDP in the aftermath. Finland is expected to reduce its government deficit to below 3% this year and see a further decline in 2023, but the budget does remain expansionary. While Finland is above the 60% government debt threshold imposed by the stability and growth pact, this hardly seems to be a problem in financial markets as current 10-year yields are at 50 basis points.

Finland in a nutshell

	2020	2021F	2022F	2023F
GDP (%)	-2.8	3.5	2.5	1.6
Private consumption (%)	-4.7	3.4	3.2	1.4
Investment (%)	-0.8	2.8	4.1	3.2
Government consumption (%)	0.2	3.4	0.1	-0.2
Net trade contribution (%)	0.1	0.2	-0.4	0
Headline CPI (%)	0.4	2.1	2.5	1.8

Source: Macrobond, ING estimates

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