

Eurozone economy sees a small contraction as inflation plunges

A drop in eurozone GDP keeps a small technical recession in the second half of 2023 a realistic prospect. With inflation falling faster than expected, the debate within the European Central Bank's governing council is set to turn more dovish, but don't expect rate cuts anytime soon



GDP decline is not meaningful, broad stagnation continues

The drop of 0.1% quarter-on-quarter in eurozone GDP is not very dramatic. It was led by Irish GDP falling by 1.8% – a figure which is often subject to dramatic revisions. Germany experienced a small decline of 0.1%, while Italy stagnated over the quarter. Growth in France and Spain remained positive but still lower than last quarter. All in all, growth continued to trend around zero in the third quarter.

While a technical recession is certainly possible in the second half of this year on the back of the third-quarter GDP reading and a weak start to the quarter according to first business surveys, we don't see too much reason for real alarm so far. It does look like the economic environment is weakening at the moment, but no sharp recession is in sight either. Still, continued economic and geopolitical uncertainty alongside the impact of higher rates on the economy will weigh on

economic activity in the coming quarters.

Inflation surprises should make ECB debate more dovish at coming meetings

Inflation is really looking more benign at the moment. It has been falling for some time, but the pace of declines disappointed up until summer. September and October surprised positively despite high oil prices and still stubborn wage growth, which adds to confidence that inflation is slowly getting under control.

The October decline from 4.3 to 2.9% was mainly driven by base effects from last year's high energy prices, but core inflation also continues to come down. Month-on-month price growth does not get reported on but a quick calculation suggests that goods prices rose well under 2% annualised in October, while services prices remained more sticky around 3.5% annualised. While high services inflation remains a concern, these figures do mean that annual core inflation – currently at 4.2% – will likely trend lower over the coming months. Especially as businesses are not indicating a new surge in prices is expected.

The numbers start to point to a much better inflation environment, especially now that the economy is clearly performing much weaker than last year and most of the impact of recent hikes is still in the pipeline. While the European Central Bank (ECB) will be very keen to avoid making the mistake of the 1970s by easing too soon and allowing another spell of high inflation later, debates over whether current restrictive levels of interest rates are not too strict are set to grow louder in the months ahead. Don't expect the ECB to lower rates anytime soon though; upside risks to inflation will weigh heavily in the central bank's decision-making at the coming meetings.

Author

Bert Colijn

Senior Economist, Eurozone

bert.colijn@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>.