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Germany: Recession avoided – for now

The German economy is showing some unexpected resilience; however it is a long way off displaying a strong economic recovery

Olaf Scholz has served as German chancellor since December 2021

The German economy started the new year with positive news. Kind of. According to the first very tentative estimates by the statistical office, the economy avoided a contraction in the fourth quarter and 'only' stagnated. The positive effects of the post-lockdown rebound seem to have outweighed the negative impact of the war in Ukraine and surging energy and food prices.

Even though this first estimate could still be subject to revisions, it definitely shows that the German economy has been more resilient despite a long series of crises in 2022, which threatened to push the economy into a deep recession. The reason for this resilience is not so much the structure of the economy but rather a simple policy recipe that the German government has successfully used over the last 15 years and perfected recently: fiscal stimulus. Contrary to common belief and what German governments have often preached to other European governments: in times of crisis, the government prefers outright fiscal stimulus. This was the case during the financial crisis, during the Covid-19 pandemic and now as a response to the war and the energy crisis. What German governments perfected during the pandemic and last year's crisis is the use of big ballpark figures, hoping that eventually not all the money will have to be used. During the pandemic, outright fiscal stimulus amounted to more than 10% of GDP. Last year, after some months of hesitation, the government decided on several stimulus and price cap packages, amounting to a total of some 8% of GDP. The announcement effect and the actual money saved the economy from falling into recession, at least for now.

Not falling off the cliff is one thing, staging a strong rebound, however, is a different matter. And there are very few signs pointing to a healthy recovery of the German economy any time soon. First of all, we shouldn't forget that fiscal stimulus over the last three years stabilised but did not really boost the economy. Industrial production is still some 5% below its pre-pandemic level and GDP only returned to its pre-pandemic level in the third quarter of 2022. Industrial orders have also weakened since the start of

2022, consumer confidence, despite some recent improvements, is still close to historical lows, and the loss of purchasing power will continue in 2023. Finally, like every eurozone economy, the German economy still has to digest the full impact of the ECB rate hikes. Demand for mortgages has already started to drop and in previous hiking cycles it didn't take long before the demand for business loans also started to drop.

While the German economy will still have to cope with the delayed impacts of last year's crises, there are a few positive developments: the reopening of China could help the battered export sector, and the prospects of decreasing inflation rates could support private consumption. However, when it comes to inflation, do not forget that households will not benefit from lower gas wholesale prices but are only now confronted with the pass-through of the energy price surge of 2022. At the same time, wage growth of at least 5% year-on-year this year and another 3-4% next year as well as the pass-through of high energy prices to other sectors of the economy will leave core inflation stubbornly high.

Germany's economic outlook for this year looks complicated, to say the least, with an unprecedentedly high number of uncertainties and developments in opposing directions. And there is more. Let's not forget that the German economy is still facing a series of structural challenges which are likely to weigh on growth this year and beyond: energy supply in the winter of 2023/24 and the broader energy transition towards renewables, changing global trade with more geopolitical risks and changes to supply chains, high investment needs for digitalisation and infrastructure, and an increasing lack of skilled workers. This long list embodies both risks and opportunities. If historical lessons from previous structural transitions are of any guidance, even if managed in the most optimal way, it will take a few years before the economy can actually thrive again.

The German economy in a nutshell (%YoY)

	2021	2022F	2023F	2024F
GDP	2.6	1.9	-0.1	0.5
Private consumption	0.4	4.9	0.6	0.5
Investment	1.0	0.4	0.4	4.0
Government consumption	3.8	2.3	6.5	4,2
Net trade contribution	0.7	-1.4	-1.4	-1.0
Headline CPI	3.1	8.7	5.5	2.8
Unemployment rate (%))	3.6	3.2	3.5	3.3
Budget balance as % of GDP	-3.7	-2.6	-4.5	-2.5
Government debt as % of GDP	71.0	72.0	70.0	68.0

Source: Thomson Reuters, all forecasts ING estimates

France: Activity to stagnate, inflation to peak

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After a resilient 2022 in France, where economic activity grew by 2.6%, 2023 should be characterised by quasi-stagnation. Inflation is expected to rise further, before starting to fall in the summer of 2023

French Economy Minister Bruno Le Maire

2022, a year of resilience

In France, the year 2022 was characterised by resilience in activity despite the negative impact of the war in Ukraine and global inflation. The end of the restrictive Covid measures led activity in services to rebound significantly, while very expansionary public policies and the strength of the labour market largely supported household purchasing power, leading French GDP to grow by around 2.6% over the year. As a result of the government's policy of limiting the increase in French energy bills, French inflation remained much lower than in other European countries in 2022, averaging 5.2% (5.9% for the harmonised index).

Higher inflation in 2023 than in 2022

While most European countries have already passed the peak of inflation, inflation in France is expected to rise further in the first quarter of 2023. The revision of the “tariff shield” will lead to a 15% increase in household energy bills, compared to a 4% increase in 2022. Many companies are facing the first upward revision of their energy bills since 2021. Rising production costs are expected to continue to support inflation in food and manufactured goods. In addition, the four indexations of the minimum wage to inflation in 2022 will continue to lead to increases in all wages, which will push up inflation significantly, particularly in services, in 2023. Ultimately, average inflation in 2023 will probably be higher than in 2022 (we expect 5.5% for the year, and 6.3% for the harmonised index), with a peak above 6.5% in the first quarter, before gradually declining from the summer onwards. At the end of 2023, inflation will probably still hover above 4%, a level higher than the European average. The deceleration should continue in 2024, with inflation averaging 2.6% over the year (3.5% for the harmonised index).

Near stagnation of activity in 2023

2023 should be characterised by a quasi-stagnation of the French economy in all quarters of the year. Although nominal wages per capita are expected to rise by around 6% in 2023, real purchasing power per person will remain very weak, weighing on private consumption. Given the uncertainties, the expected (albeit small) rise in the unemployment rate and the low level of household confidence, the household savings rate will probably remain high and above its historical average. Household investment in housing is likely to stall, weighed down by higher commodity prices and rising interest rates. The manufacturing sector should continue to see supply difficulties ease but will face much weaker global demand and will still be at risk of a further significant rise in global energy prices. We expect growth of 0.2% for the full year 2023 and 1.1% for 2024.

Difficult exit from "whatever it costs"

While in several European countries trade unions and public opinion are mobilising to demand wage increases, in France the protests are focused on pension reform. The government wants to implement reform that will, among other things, raise the legal retirement age from 62 to 64 in order to maintain the budgetary sustainability of the system. Although the reformed system can still be characterised as generous in comparison with its European neighbours, the unions and the political left are strongly opposed to it. The scale of the mobilisation has yet to be confirmed on the streets. After years of "whatever it costs" where the government has largely subsidised activity (in 2022 alone, 50 billion euros have been spent to protect households and companies against inflation), fiscal sustainability has disappeared from the political debate. As a result, fiscal policy is likely to remain quite accommodative in the coming years. The deficit is expected to remain above 5% of GDP until 2025 with debt above 112%.

The French economy in a nutshell (%YoY)

	2021	2022F	2023F	2024F
GDP	6.8	2.6	0.2	1.1
Private consumption	5.3	2.5	0.1	0.9
Investment	11.4	2.7	0.8	0.4
Government consumption	6.3	2.4	-1.1	0.0
Net trade contribution	-0.1	-0.4	0.2	0.3
Headline HICP	2.1	5.9	6.3	3.4
Unemployment rate (%, Eurostat definition)	7.9	7.3	7.4	8.0
Budget balance as % of GDP	-6.5	-5.5	-5.4	-5.4
Government debt as % of GDP	114	112	113	115

Source: Thomson Reuters, all forecasts ING estimates

Italy: A soft growth patch vulnerable to inflation developments

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Despite solid employment resilience, consumption looks set to decelerate in 2023. Still, together with investment, it should keep growth in positive territory

Giancarlo Giorgetti, Italian Minister for Finance

The jury is still out as to whether the Italian economy contracted in the fourth quarter of 2022, and we currently expect to see a minor -0.1% quarter-on-quarter fall in GDP. This year will likely see a soft start, followed by a gradual recovery over the rest of the year. The growth profile will be hugely affected by developments on the inflation front and their impact on both disposable income and domestic demand.

Gradual inflation decline, with energy fall prevailing over core stickiness

The sharp decline in TTF natural gas prices seen over the past month (falling 60% to around 60€/MWh) should have a positive impact on the energy component of the inflation basket, creating room for positive base effects on headline inflation to unfold over the first months of 2023. The pass-through of energy price pressures is not over yet and will likely weigh on core inflation for some time.

Signals from the business sector point to a decline in intentions to hike prices among manufacturers but not yet in services, suggesting that some form of reopening-induced consumption is still at work. Over the first half of the year, we expect the drop in energy inflation to outweigh the inertia in the core inflation component. This should induce a gradual decline in the headline index, which is expected to end the year above 2.5% year-on-year.

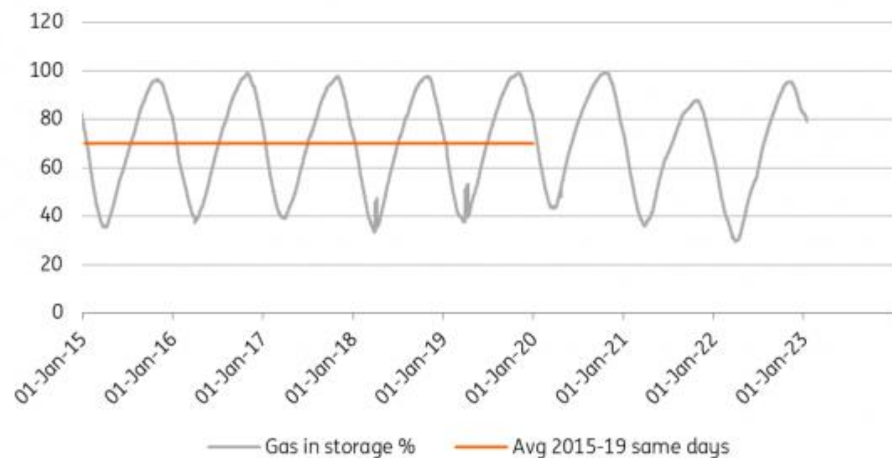
Resilient employment should help limit the damage

Stubborn inflation is weighing on disposable income, but the effect is less noticeable than we had expected. In the third quarter of last year, real disposable income increased by 0.3% quarter-on-quarter despite accelerating inflation, mainly thanks to surprisingly strong labour market data. In November, against a backdrop of an economic slowdown, employment confirmed its peak at pre-pandemic levels. The unemployment rate, admittedly a backwards-looking indicator, was stuck at a multi-year low of 7.8%. High gas storage levels, which were just below 80% full by mid-January and resulted from

unusually mild weather, further reduced the chance of energy rationing this winter and limited the scope for short-term supply shocks.

Still, with a modest deterioration in employment and shrinking room for substantial declines in the saving ratio (which fell to 7.1% in 3Q22, the lowest level since 4Q12 and below the pre-Covid average), we anticipate consumption will cool down over the 4Q22-1Q23 period. We then see it picking up at a moderate pace so long as inflation recedes. A short-lived and soft technical recession in the first quarter of 2023 remains our base case, but short-term upside risks are rising.

Unusually high gas storage levels make energy rationing unlikely this winter



Source: AGSI+, ING Research

Investment still growing

Private investment should also, in principle, remain a positive growth driver in 2023. This will build on two factors: a residual drive of residential construction investment fuelled by tax incentives, and the flow of new investments linked to the implementation of the national recovery and resilience plan (RRP). Both are exposed to downside risks, though. If residential construction suffers from the impact of rising interest rates, risks to the RRP front could emerge as the balance between reforms and investments shifts towards the latter. Further adding to the issue could be involvement from local administrations, which are less equipped to manage complex projects.

Fiscal discipline: a valuable political capital for upcoming negotiations

The macro backdrop described above will fit into a prudent fiscal framework. The Meloni government crafted its 2023 budget with a piecemeal approach, in continuity with the Draghi government. Almost two-thirds of the €34bn budget is devoted to refinancing deficit measures designed to support (until 31 March 2023) households and businesses weathering the inflation shock. The rest is dispersed among other measures, ranging from refinancing the cut to the tax wedge (again, in continuity with the Draghi government) to extending a flat tax system for independent workers.

The government aims at a 4.8% deficit/GDP target for 2023, which implies a 1.1% reduction in the structural deficit. Fiscal discipline will be a valuable political capital to be spent in upcoming negotiations on reforming the stability and growth pact. In our view, risks to this for 2023 lie on the side of a slightly higher deficit but not enough to jeopardise another decline in the debt/GDP ratio. For the second year in a row, the inflation effect (through the GDP deflator) is set to work its magic on the debt ratio.

The Italian economy in a nutshell (% YoY)

	2021	2022F	2023F	2024F
GDP	6.7	3.9	0.5	1.4
Private consumption	5.1	4.8	1.8	1.2
Investment	16.5	9.7	2.5	1.9
Government consumption	1.5	0.3	0.0	0.4
Net trade contribution	-0.1	-1.0	-1.0	0.1
Headline CPI	1.9	8.7	6.7	2.4
Unemployment rate (%)	9.5	8.1	8.1	8.2
Budget balance as % of GDP	-7.2	-5.4	-4.8	-3.7
Government debt as % of GDP	150.3	145.8	144.6	143.2

Source: Thomson Reuters, all forecasts ING estimates

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The Netherlands: sluggish growth in 2023

Dutch GDP is forecast to grow by a mediocre 0.4% in 2023 and a close-to-normal 1.4% in 2024. A short and mild recession is forecast to last until the first quarter of 2023, with GDP moderately picking up during the rest of 2023. Inflation has peaked but remains high, as core inflation is still on the rise. Fiscal expansion is the main driver of growth

Mark Rutte, prime minister of The Netherlands

2022 closed with another contraction, despite robust private consumption

While inflation in the Netherlands was among the highest of its peer economies in the eurozone, Dutch domestic private consumption held up surprisingly well, even going into the fourth quarter of 2022. Although not buoyant, retail sales and domestic consumption volumes have been showing stability or even some growth. Large amounts of savings (accumulated during lockdowns, particularly in the upper half of the wealth distribution), the €190 payout households received via their energy bill in November and December, accelerating wage increases, continuing low unemployment, and the certainty provided by the energy price ceiling for 2023 seem to contribute to robustness in consumer spending at the end of 2022, despite an environment of higher core inflation and low measured consumer confidence. As such, household consumption is forecast to have continued to grow in the fourth quarter of last year.

As the outlook for net trade and investment has worsened with tougher financing conditions and high input cost inflation throughout Europe, Dutch GDP is nevertheless likely to continue to contract in 4Q22. Despite contractions in the last two quarters of 2022, the annual growth figure of 4.3% for that year represents a strong expansion. This stems from the strong rebound out of lockdown in the first half of the year.

2023 starts worse before it gets better on the back of public spending

Government spending will be the main driver of GDP growth in 2023, while net trade and investment will be a drag on the GDP development, and private consumption is set to only expand negligibly.

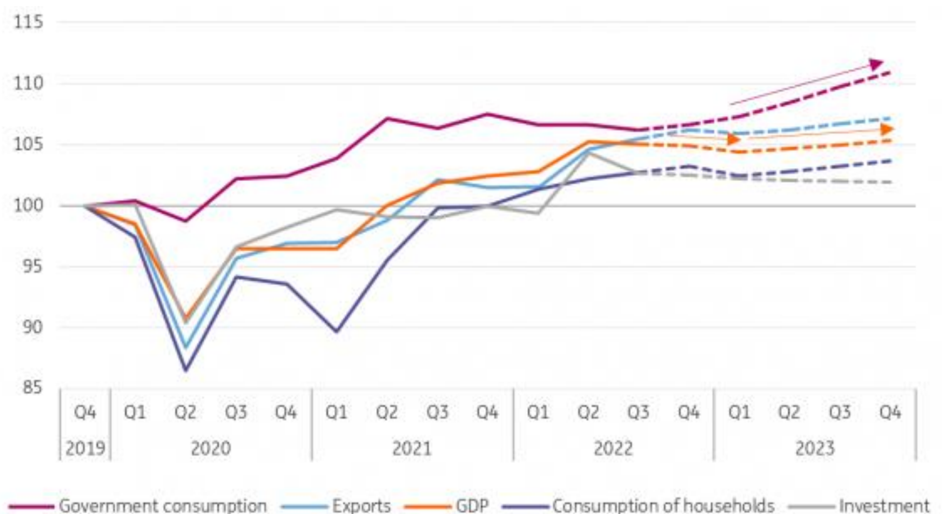
Private consumption may start the year in the first quarter with a decline: as energy taxes and the VAT on energy were normalised, the €190 lump sum terminated, and the energy price ceiling was introduced as of 1 January 2023, energy costs net of taxes may

de facto have risen for some households – depending on their energy consumption level and contract – and fallen for others. Still, consumer confidence is low. Falling house prices and a lower number of home sales will provide a lid on consumption growth and are a risk for weaker-than-expected consumption. As inflation will fall, private consumption is expected to expand (although sluggishly) for the year on average. It indirectly benefits – via the multiplier effect – from the increased execution of ambitious plans in the coalition agreement and is still directly supported via the energy crisis support measures and some structural policy changes.

Companies are increasingly signalling a downward pressure on profitability. This, the recession in the eurozone, and the prospect of a weakened global business cycle, makes it less attractive to invest, for instance in machinery. Higher financing costs due to interest rate increases also put a brake on investment. The development of building permits, due to insufficient capacity in municipalities and due to the nature of protection policies, indicates a decline in investment in construction work in 2023. This concerns housing and commercial premises and mobility infrastructure. In 2023 there is a risk that investment in buildings will fall for the first time since 2013. Both exports and investment will benefit however from backlogs in transport equipment. Due to previous major issues in global supply chains and the resulting delays in production and delivery, there are still many orders from 2022 that will be fulfilled this year. This is particularly true for passenger cars and to a lesser extent for heavy vehicles such as trucks and busses. Without this shift in time, the outlook for exports and investment would have been worse for 2023. For vans, the prospects are somewhat weaker, while ordered vessels may not be delivered until 2024.

Mild GDP decline continues into 1Q23 as private expenditures weaken, but pick up in 2023 due to government spending

Expenditures* as index where 4Q2019 = 100



*Seasonally adjusted and in constant prices
Source: Macrobond, ING Research forecasts as of 4Q22

Higher financing costs for businesses resulting from higher market interest rates, generally lower profit margins and the challenge of paying back deferred taxes (accumulated during the pandemic) will also contribute to more business dynamics in 2023. This will facilitate a quicker movement of labour and capital from unproductive sectors and firms towards those with more growth potential, which could be beneficial for labour productivity. The number of bankruptcies has indeed recently started to increase recently but is still far below normal rates. A normalisation should coincide with higher unemployment. Yet, we forecast only a mild uptick in joblessness. As ING research shows, when European economies enter a recession with much strain in the

labour market, the subsequent increase in unemployment is more limited. This can be explained by labour hoarding: solvent firms are unwilling to let go of their skilled personnel even during a downturn, trying to avoid hiring and training costs and the loss of firm-specific knowledge. Furthermore, while the market sector may have moved in a lower gear, (semi)public sectors will take over some of the employment.

Vast government spending means fiscal deficits. Inflation is keeping the debt burden limited, however. Although the budgetary process was messy lately, with the government not adhering to its own fiscal rules and seems to have more easily led to uncovered additional spending, the ability of the Dutch government to finance its debt is not a serious concern for now: the public debt-to-GDP ratio is still low by international standards.

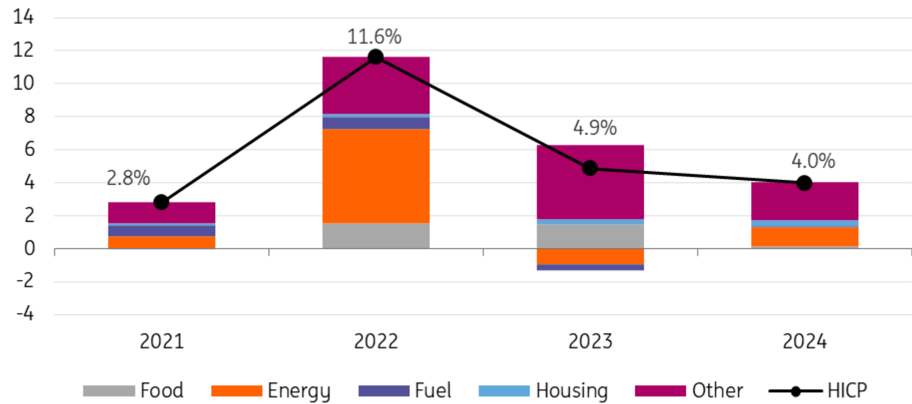
Inflation is past the peak, but remains high

HICP headline inflation reached its peak in September 2022, but at a forecast of 4.5%, it's set to remain quite high in 2023. As gas prices have come down in wholesale markets and the energy price ceiling was introduced in early 2023, energy will contribute less (and in some months negatively) to inflation. Selling price expectations of non-financial businesses remain very high though. This suggests that core inflation might peak somewhere later in 2023. Earlier peaks in purchasing prices of inputs like raw materials, transportation, and energy will still be passed onto consumers, while higher labour costs will also continue to drive inflation up. The reversal of the following temporary policies will also contribute to rising prices for consumers in 2023:

- The energy tax (on gas and electricity) was temporarily lowered for 2022. This will be normalised in 2023.
- The VAT rate on energy was temporarily lowered from 21% to 9% for July-December 2022. This will be normalised in 2023.
- The excise duty on fuel (gasoline and diesel) was lowered temporarily to 21% for April-December 2022. This will be normalised in 2023.
- College tuition fees halved during the Covid-19 pandemic period and normalised in September 2022. This will drive 2023 inflation upward (+0.25% points).
- Covid-inspired regulation kept a lid on the increase of rents in both the social housing sector and the liberalised sector, at least until policy changes as of 1 July 2022 and 1 January 2023. Normalisation and reforms of the policies might on average be more inflationary for 2023, although there are also some lower-income households for which the reform is beneficial (as more will be income tested).
- The excise tax on a pack of cigarettes will be increased in two substantial steps, to €10. The first step in April 2023 is estimated to have a nonnegligible effect on the HICP inflation rate of +0.6% points in 2023.

Inflation past peak but still high

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



Source: Macrobond, forecasts as of 2023 by ING Research

The expiration of the energy price cap at the start of 2024 will result in higher inflation that year. Combined with some remaining pressure in core inflation, headline inflation might still be close to 4% in 2024.

The Dutch economy in a nutshell (% YoY)

	2021	2022F	2023F	2024F
GDP	4.9	4.3	0.4	1.4
Private consumption	3.6	6.5	0.6	1.7
Investment	3.3	2.9	-0.1	1.0
Government consumption	5.2	0.2	2.4	3.1
Net trade contribution (%-point)	1.5	1.0	-0.7	-0.2
Headline HICP	2.8	11.6	4.9	4.0
Unemployment rate (%)	4.2	3.5	3.6	3.4
Budget balance (% of GDP)	-2.6	-1.6	-5.7	-3.9
Government debt (% of GDP)	52.4	49.9	54.3	55.4

Source: Macrobond, all forecasts ING Research estimates

Spain: leads the pack for European growth in 2023

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We expect Spain's economy to grow by 0.9% this year, considerably less than in 2022, but better than most other eurozone countries. Headline inflation will fall further thanks to favourable energy effects but underlying inflationary pressures will remain high for some time

Thanks to a relatively more service-oriented economy and a positive contribution from tourism, Spain is likely to outperform the eurozone average

The strong reopening effect completely faded away in the second half of 2022

The Spanish economy cooled sharply in the second half of last year. Although the big drop in energy prices and cooling inflation have led to cautious optimism among companies and households, we expect the recovery to be very slow this year. Financial conditions will tighten further in 2023. The European Central Bank announced at the last policy meeting in December that interest rates still need to go significantly higher, and further 50bp rate hikes will follow. The ECB's deposit rate now sits at 2%, the level considered the neutral level where the economy is neither stimulated nor restricted. Thus, additional interest rate hikes will certainly dampen economic activity in 2023.

Consumption will also remain under pressure as inflationary pressures will further erode purchasing power in 2023. Households are also very cautious about tapping into the savings accumulated during the Covid-19 pandemic to maintain consumption. The current energy crisis is just prompting more precautionary savings and, moreover, the value of these savings has already been eroded by the sharp price increases. In addition, rising mortgage rates will take an extra bite out of the budget of Spanish borrowers with variable interest rates, which are the majority in Spain. On the other hand, the tight labour market will support consumption.

Spain likely to outperform other eurozone countries in 2023

We expect the Spanish economy to do slightly better than the eurozone average. Spain is less dependent on gas and the economy is relatively more reliant on the service sector. A further recovery in the tourism sector will also contribute positively to growth rates. In the first 11 months of 2022, the number of international visitors was still 15% lower than in the same period in 2019. We expect the number of international visitors to

continue to rise gradually and exceed pre-crisis levels by summer. Finally, the roll-out of Next Generation EU (NGEU) funds will make a positive contribution to growth rates in 2023.

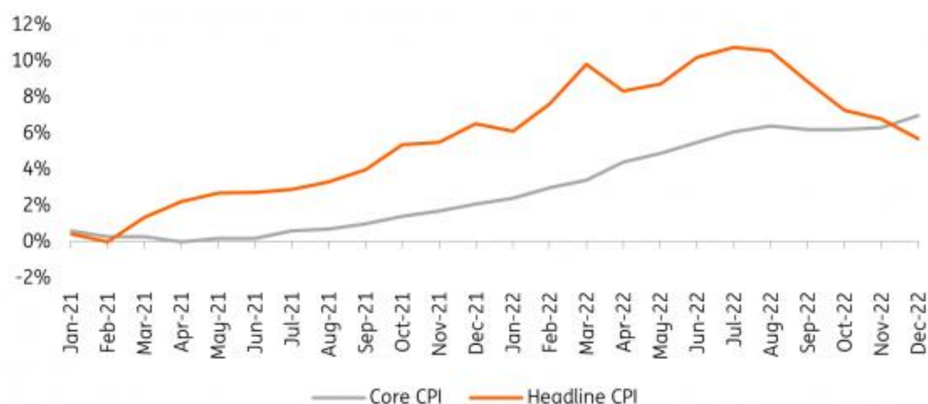
In addition, the housing market is also much healthier than during the financial crisis. The high number of households with variable interest rates is a risk, but for now, there are no worrying signs that the number of households unable to repay their loans is rising sharply, helped by some government measures introduced last year. A scenario similar to what was seen during the financial crisis will not be repeated. The sharp rise in interest rates and the energy crisis will likely put an end to the sharp price increases of recent years, but we expect this to be very gradual. For this year, we expect house prices to grow by about 1%.

Underlying inflationary pressures remain high

Spanish inflation has cooled solidly since its peak. Harmonised inflation fell to 5.5% in December from 6.7% the month before, significantly below the eurozone average of 9.2%. The fall in Spanish inflation has started much earlier and more firmly than in other eurozone countries, thanks to a host of government measures and a greater cooling of energy inflation. Electricity inflation already turned negative in October and gas inflation is also falling sharply. In late December, Spain's Sanchez government announced a new €10bn package to address the cost-of-living crisis. The new package includes a VAT cut on essential food items and a six-month rent freeze, which will further reduce inflation in the coming months. Although lower energy prices and government measures have brought some temporary relief to headline inflation, the inflationary pressures in the rest of the economy are still very high. Core inflation, excluding the more volatile food and energy prices, reached a record high of 7% in December, a strong acceleration from 6.3% in November. As a result, core inflation is now above headline inflation for the first time since the start of 2021.

For 2023, we project average inflation at 3.7%. Although the headline inflation will fall further thanks to these favourable base effects for energy, it will take somewhat longer for the pace of the food price increases to moderate and for underlying inflation to resume a downward trajectory. Food inflation reached a new record high of 15.7% year-on-year in December and the feed-through of higher labour and energy costs to final food prices is likely to continue in 2023. Moreover, fertiliser exports were severely disrupted last year, which might also affect global food production in 2023 and push food prices up. Moreover, fertiliser exports were severely disrupted last year by the war in Ukraine, which could also affect global food production in 2023 and cause higher food prices. Moreover, the Iberian gas price cap also expires at the end of May, meaning gas-fired power plants will have to pay more for their gas again. This will also put upward pressure on the inflation rate.

Spanish core inflation above headline inflation for the first time



Source: INE

Modest growth rate in 2023

Spain experienced a very strong reopening effect after the pandemic, but this effect faded away in the second half of 2022. Tightened financial conditions and an ongoing cost of living crisis will weigh on the growth outlook in 2023. Thanks to a relatively more service-oriented economy and a positive contribution from tourism, Spain is likely to outperform the eurozone average. For 2023, we expect growth of 0.9%.

The Spanish economy in a nutshell (%YoY)

	2021	2022F	2023F	2024F
GDP	5.5	4.3	0.9	1.9
Private consumption	6.0	1.8	0.4	2.0
Investment	0.9	4.9	1.8	2.2
Government consumption	2.9	-1.4	0.1	0.1
Net trade contribution	0.3	3.3	-0.3	-0.5
Headline CPI	3.0	8.5	3.7	2.6
Unemployment rate (%))	14.8	12.8	12.9	13.4
Budget balance as % of GDP	-6.9	-4.3	-4.7	-4.3
Government debt as % of GDP	118.3	113.9	113.2	112.6

Source: Thomson Reuters, all forecasts ING estimates

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Greece: Uncertainty to grow amid upcoming elections

The end of re-opening effects will bring about softer demand as normalising fiscal policy takes away extra support. Upcoming elections will also add a pinch of political uncertainty to the mix

Greece's prime minister Kyriakos Mitsotakis

Greece's economic profile

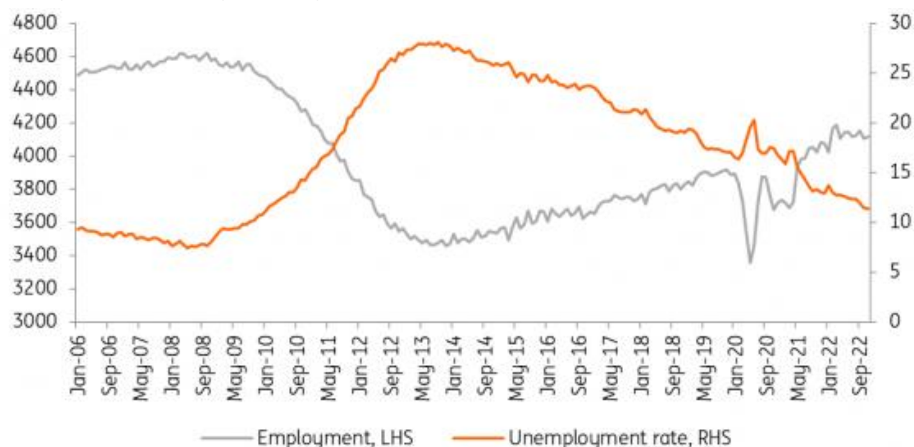
The Greek growth profile has recently reflected developments on the inflation front. The acceleration of inflation over the summer (culminating in September's 12.1% peak) took its toll on consumption, which saw a 0.1% quarter-on-quarter contraction in the third quarter of 2022 despite generous energy subsidies. Together with a net export drag, this caused a 0.5% contraction in GDP for the third quarter of 2022. We suspect a similar pattern will follow in the fourth quarter despite confirmed fiscal support and decelerating inflation.

End of re-opening effect to be followed by more domestic demand uncertainty

The outlook for 2023 remains uncertain. With GDP well above pre-Covid levels, re-opening effects should now be over. Tourism receipts also returned back to their historical peak in the summer of last year, making it unlikely that we'll see further substantial gains in 2023.

The recovery seen in employment was a powerful driver of consumption over 1H22 but now appears to be losing steam. Changes to real disposable income will increasingly depend on inflation developments, with inevitable side effects on consumption. Investments should, in principle, remain relatively supported thanks to the inflow of European Recovery Funds but will not be immune to persistent uncertainty surrounding the cost of projects.

Employment recovery is losing steam



Source: Refinitiv, Datastream

Normalising fiscal policy to help further declines in debt/GDP

Fiscal policy, while possibly accommodating some extra temporary support in the case of continued energy price disruptions, will take a more disciplined turn. The Greek budget for 2023 targets a return to a primary surplus, which is consistent with the fiscal overperformance of 2022 and a more optimistic GDP projection.

We're currently less upbeat on growth, and although the primary surplus could be slightly missed, we see a substantial fall in the debt/GDP ratio towards the 170% level materialising nonetheless. With an average debt maturity of more than 18 years, the ongoing sharp rise in interest rates can still be accommodated in the short run without raising debt sustainability concerns. The inflation tax effect, albeit less powerful than in 2022, will still be at work.

Elections also carry some uncertainty

2023 will be an election year for Greece. Legislative elections are due to be held in July, but we can't exclude the possibility of prime minister Kyriakos Mitsotakis calling Greeks to the polls a few months early. The upcoming election will be held under a purely proportional system, a shift from the previous structure, which integrated the proportional element with a majority premium and has allowed New Democracy (ND) to rule the country in isolation since 2019.

The new system will make it much more complicated for any participant to obtain a parliamentary majority. According to the latest available opinion polls, ND leads with 37% of the votes, followed by Syriza (28%) and Pasok (11.5%). With these numbers, ND would be far from reaching a majority under the new system if it does not align itself with others (Pasok). Setting up a reliable coalition may turn out to be a difficult task. Add to this a campaign which might touch upon delicate issues (such as Qatargate) along with wiretapping accusations, and you get a decent mix of potential sources for political uncertainty over the second quarter.

The Greek economy in a nutshell (% YoY)

	2021	2022F	2023F	2024F
GDP	8.1	4.9	0.7	1.6
Private consumption	6.1	7.8	0.7	1.8
Investment	19.8	8.6	3.5	5.4
Government consumption	2.4	-1.3	0.4	0.4
Net trade contribution	0.8	-1.6	-0.5	0.4
Headline CPI	0.6	9.3	4.3	2.4
Unemployment rate (%)	14.8	12.4	11.6	11.7
Budget balance as % of GDP	-7.8	-4.0	-2.9	-2.4
Government debt as % of GDP	193.3	176.0	170.3	164.5

Source: Thomson Reuters, all forecasts ING estimates

Belgium: Short-term resilience, medium-term challenges

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The Belgian economy coped well with the inflation shock in 2022. Even if 2023 looks more difficult, a strong labour market should limit the damage. But in the medium term, the economy will not be able to ignore the challenges of competitiveness and public finances

Belgium's Prime Minister Alexander De Croo attends a panel at the World Economic Forum in Davos, Switzerland, Jan 2023

Resilience

Torn between the post-Covid reopening of the economy and the negative effects of the war in Ukraine, the Belgian economy showed, like other eurozone economies, strong resilience to headwinds. For the year 2022 as a whole, GDP is expected to have grown by 3%, which puts last year's volume of activity around 3.5% above that of 2019, before the succession of negative shocks. It should be noted, however, that on the supply side of the economy, not all sectors have developed so positively: even though the figures for the fourth quarter are not yet available, it is highly likely that activity will have contracted (by around 0.3%) in the manufacturing sector in 2022. Growth is therefore essentially linked to services, and in particular to (retail) trade, which has benefited from the complete end of Covid restrictions.

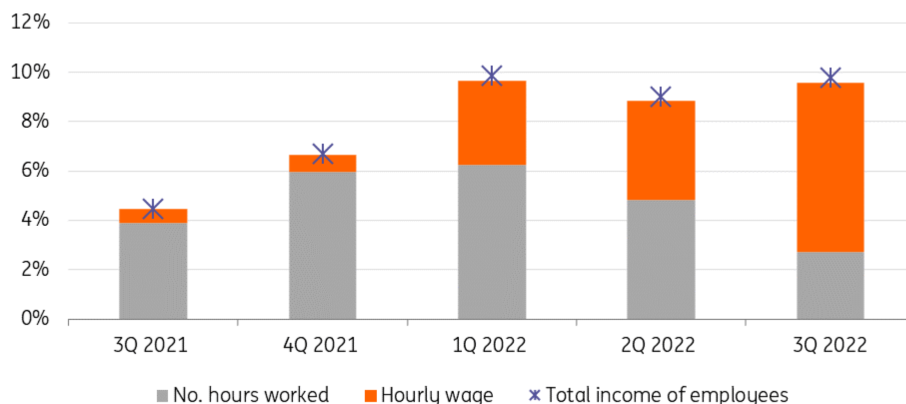
Household income holds up

It may seem surprising that in the context of the war in Ukraine and the sharp rise in commodity and energy prices, the economy, and household consumption in particular, has shown such resilience. This is most likely linked to two factors: on the one hand, the labour market has put in one of its best performances in recent decades. Indeed, according to the latest available figures, some 100,000 jobs were created in 2022, which is exceptional for the Belgian economy. Even if these are not always fixed-term and full-time contracts, the volume of hours worked has increased (+2.7% year-on-year in the third quarter 2022). This has therefore contributed to an increase in household disposable income. On the other hand, the automatic indexation of income (wages, pensions, social benefits, etc.), itself linked to the evolution of prices, has pushed income upwards, which has enabled households to cope with the energy price shock, especially as many additional measures have been taken to mitigate its effects. These two elements combined have allowed household disposable income to rise by more than 7% in 2022, or by almost €25 billion. Consequently, despite the sharp rise in prices,

households have not had to reduce their savings rate (this stood at 13.6% in the third quarter of 2022, whereas it did not exceed 12.0% on average over the three years prior to the start of the Covid), while increasing the total volume of consumption.

Recent growth in compensation of employees (YoY)

This has been driven by an increase in hours worked, but more by the nominal increase in hourly wages in 2022



Source: Statbel, NBB, computation: ING

Slight recession

However, it is undeniable that the pace of growth slowed during the year. As mentioned above, activity even contracted in the manufacturing sector. Household and business confidence have recovered somewhat in recent months, but household confidence remains very low. On the labour market, there has also been some deterioration: although temporary unemployment (which can be used by companies that are suffering too much from the rise in energy prices) has returned to its normal level, there has been a deterioration in activity in the temporary employment sector (it has fallen by more than 11% YoY in November 2022). The number of job seekers is also up by 5% over the same period.

As elsewhere, the slowdown in activity should be less pronounced than we anticipated a few months ago, thanks of course to the fall in energy prices. This is all the more true as the measures taken to combat the rise in energy bills for households will be maintained in the coming months. The manufacturing sector should also benefit from the fall in energy prices and make a positive contribution to growth.

Slow recovery…

Barring a sharp rise in energy prices similar to that seen in the summer of 2022, a slow recovery of the Belgian economy is likely to take shape in the course of the year. However, this will initially be hampered by more restrictive financing conditions for the economy, due to the rapid and significant increases in European Central Bank interest rates. This could weigh on construction activity in particular. Indeed, there is already a clear cooling of the housing market, with mortgage lending down by almost 25%. In addition, job creation is likely to slow down significantly this year, which will limit the growth of real household income, and therefore consumption.

… and inflation down, but still high

In 2022, inflation reached almost 10%. This is quite exceptional. Of course, the direct impact of rising energy prices is largely responsible for this figure. But we should not forget that in December last year, more than 70% of the prices of goods and services included in the consumer price index had risen by at least 5% over the previous 12 months. The indirect effects of rising energy, commodity and labour costs have thus played an important role in the inflation dynamics.

Thanks to the recent fall in energy prices, inflation has started to decline. It should continue to fall in the coming months, although this will probably be hampered by the desire of many companies to try to pass on the recent increases in labour costs to their sales prices. Indeed, around 500,000 workers will see their wages indexed by over 11% from this month. This is good for household income but represents a significant cost for the companies concerned.

Competitiveness and public finances, problems for tomorrow

In the end, therefore, despite the multiple shocks impacting the Belgian economy, it should get through the turbulent period without too much damage. This is at least the case at first sight. However, the shocks and the measures taken to deal with them will leave their mark. In other words, the legacy of multiple crises over recent years will continue to be felt.

On the one hand, it is known that the automatic indexation of wages is largely responsible for the increase in households' disposable income, and thus their ability to cope with the increase in energy bills. But it is also an equivalent cost for companies. Therefore, if wage growth (and therefore labour costs) does not reach an equivalent level in Belgium's trading partners, Belgium will lose competitiveness. As the inflation wave is huge, the wage cost differentials could be substantial. This may ultimately affect the economic recovery, in terms of jobs or income, if no measures were to be taken to correct the excessive wage handicap.

On the other hand, it should be noted that the state has borne the brunt of past shocks. For example, between March 2020 and the end of 2022, more than €6 billion of additional temporary unemployment benefits were paid to counter the loss of activity linked to the shocks (mainly the Covid crisis). To this must be added aid to businesses, aid to households for energy bills (tax cuts, lump sum cheques, etc.), as well as indexation of civil servants' salaries and social benefits. In the end, the budget deficit has struggled to fall since 2020, and should still approach 5% of GDP in 2022 and 2023. It should also be added that the level of interest rates on the markets is now higher than the average financing rate of the existing debt, and the replacement of maturing debt will tend to increase the latter.

No major corrective measures are currently being put in place, while the prospect of federal and regional elections in 2024 will make it increasingly difficult for the parties in the broad governing coalition to reach agreement. For the same reasons, the much-needed structural measures to reform the labour market and the pension system are also in jeopardy.

The health of public finances is likely to be a drag on the economy sooner or later. Corrective measures will inevitably include tax increases or spending cuts. The question is when the pressure will be felt to take these corrective measures. This may come from the new European fiscal rules under discussion, or from a loss of creditor confidence in the financial markets. The former may still take some time to be decided, while the latter is unpredictable.

The Belgian economy in a nutshell (% YoY)

	2021	2022F	2023F	2024F
GDP	6.1	3.0	0.2	1.0
Private consumption	5.5	3.9	0.5	1.1
Investment	4.9	-1.4	-0.8	1.4
Government consumption	4.8	-0.4	1.6	1.8
Net trade contribution	0.7	0.4	-0.2	-0.2
Headline CPI	2.4	9.6	5.8	2.1
Unemployment rate (%))	6.3	5.5	5.8	6.0
Budget balance as % of GDP	-5.6	-5.5	-5.1	-5.3
Government debt as % of GDP	109.2	103.8	104.6	106.9

Source: Thomson Reuters, all forecasts ING estimates

Austria: Warm weather a double-edged sword for Austrian growth

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There are two main drivers of Austria's economic activity: industry and tourism. While the current mild temperatures are benefiting industry, they are damaging ski tourism

Skiers in the Austrian state of Salzburgerland this month. Due to higher temperatures, there is less snow this year and the quality of the snow is worse

Austria's economy is struggling

In the third quarter of 2022, the Austrian economy recorded meagre growth of 0.2% quarter-on-quarter. The industrial sector in particular supported growth, while the hospitality and other services sectors had a negative impact on growth. Flash estimates for economic growth in the fourth quarter of 2022 will only be released at the end of January, but we do not expect that the Austrian economy managed to grow again – high inflation, uncertainty, and a strong dependence on exports in an environment where the global economy is slowing argue against this.

Like almost every European country, Austria is feeling the economic impact of the war in Ukraine. High energy costs, high food prices and high uncertainty among companies and households are weighing on consumer and business sentiment in Austria, although leading indicators improved from low levels recently. However, the PMI for manufacturing stood at 47.3 most recently, which not only indicates a contraction of the sector but is also lower than the eurozone number. Weak business sentiment doesn't come as a surprise, given the high dependence on Russian gas. Austria imports around 90% of its gas consumption. Prior to the war, 80% of gas imports came from Russia. In November 2022, however, the share of gas imported from Russia had dropped to roughly 40%.

Inflation high; consumer confidence low

Highly filled gas reserves and mild temperatures have avoided a gas supply crisis and seem to have boosted economic sentiment. Most recently, the gas storage facilities were filled at 88% capacity a year ago, the level was about 40%. Even if the current winter seems to proceed without economic accidents, a requirement for more energy independence is a further acceleration of the green transition. The Austrian government is providing some €3bn and an additional €2.7bn will be made available for environmental funding, to promote Austria as a research and business location and for

support with additional energy efficiency measures. In total, these measures correspond to 1.4% of 2021's GDP.

Consumer confidence, as measured by the European Commission's consumer survey, was also lower in Austria than in many other eurozone countries in all three months of the fourth quarter of 2022. Inflation averaged 8.6% in Austria in 2022, and for the next 12 months, Austrians expect prices to continue to rise. We also assume that inflation will remain high in 2023, even if double-digit inflation rates should no longer appear in the statistics. Persistently high inflation is also affecting Austrian households' propensity to save, which has increased recently, according to the OeNB's consumer survey. But it's not just Austrians who are saving more and spending less – the cost of living has also risen in neighbouring countries. As a result, many people are skipping ski vacations. According to a YouGov survey from October 2022, only 25% of Germans want to spend their skiing vacation as planned – the rest are shortening their travel time, cancelling their vacation altogether, or avoiding local gastronomy services. And what makes matters worse is that due to the mild weather and associated lack of snow, only around half of the slopes in Austria are open. After suffering from the pandemic in recent years, ski tourism is being hit by two factors this season: lower private consumption at home and abroad and the warm weather.

On a more positive note, despite the difficult economic environment, we expect the Austrian labour market to remain relatively stable in 2023. Although unemployment rose to 5.6% in December 2022, we do not expect widespread waves of layoffs. This is mainly due to labour shortages, which are particularly prevalent in Austrian handcraft and hospitality companies and affect a total of 73% of Austrian businesses. Furthermore, companies and households are being supported by various government support measures. The latest example of such measures is the electricity price brake, which came into effect in December 2022. Due to those support measures, however, Austrian government debt increased recently. In the third quarter of 2022, government debt rose to €355.6bn from €333.1bn in the previous quarter. However, the debt ratio fell to 81.3%, driven by economic growth. In 2023, we expect the debt ratio to fall further, but government support coupled with only low growth from the second quarter of 2023 onwards comes at the price of a slower-than-expected decline in the debt ratio.

In contrast to other eurozone countries, the warm temperatures of recent weeks do not only bring relief for Austria. They are a double-edged sword, also threatening the overly important tourism sector. In any case, 2023 will be another economically challenging year in which we expect the Austrian economy to contract slightly.

The Austrian economy in a nutshell (%YoY)

	2021	2022F	2023F	2024F
GDP	4.5	4.8	-0.4	1.1
Private consumption	3.3	5.0	-0.9	1.8
Investment	4.0	3.5	2.0	4.0
Government consumption	6.7	0.2	0.8	0.5
Net trade contribution	0.1	-1.0	-0.3	0.5
Headline CPI	2.8	8.6	5.8	2.1
Unemployment rate (%))	6.2	4.8	4.9	4.4
Budget balance as % of GDP	-5.9	-6.3	-3.0	-1.3
Government debt as % of GDP	82.8	82	79.0	75.0

Source: Thomson Reuters, all forecasts ING estimates

Ireland: maintains strong growth trend

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Ireland's economy boomed in 2022 and the same is expected this year. The country has been relatively unscathed by the energy crisis, but high inflation will weigh on household consumption

Leo Varadkar, Ireland's Taoiseach

Structural outperformance

The Irish economy continued to outperform the rest of the eurozone in 2022 and is likely to do the same in 2023. We're currently expecting the Irish economy to have grown by just under 12% in 2022. It is well known that this is in part due to multinational accounting activity, which inflates the Irish GDP growth figure. This is causing volatility in the data, which has become worse in recent times. But this is not the only reason for Ireland's strong performance. Modified domestic demand, the preferred measure for economic activity from the Irish statistical office, is expected to have grown in the double-digits last year as a sign of an economy that is booming beyond accounting statistics.

The Irish economy is set up incredibly well to handle the aftermath of the Covid-19 pandemic and energy shock. Its main growth engines ahead of the crises were already the pharmaceutical and ICT sectors, which both profited from the pandemic and have been relatively unscathed by the energy crisis. Having comparatively few energy-intensive industries, Ireland has been able to maintain a dizzying growth pace. This has shown in the domestic labour market as unemployment has bottomed out at just above 4% at the moment and more people than ever are in work.

But 2023 will see moderation

For 2023, some correction can be expected as high inflation will continue to weigh on household consumption with reopening effects fading and real wages likely to remain negative for some time. Besides that, higher interest rates are set to cool off business investment, which has also been growing at a stellar pace. These factors should lead to a normalisation of economic activity after the abnormally strong 2022. Still, we expect the GDP growth rate to drop only to 3.8%, which is still far higher than the eurozone average.

The housing market remains a key concern in the Irish economy. Housing supply continues to be a problem and even though interest rates rose dramatically over 2022, house prices have yet to show a peak while other European countries are cautiously experiencing a turning point for prices. With interest rates rising, housing affordability is reducing, adding to the problem. Still, some cooling in prices is not unimaginable as the ECB raises interest rates further in 2023.

Healthy government finances continue

From a government debt perspective, Ireland will go through an unexciting year. The government reshuffle has brought Leo Varadkar back into the position of Taoiseach but won't see a landslide change in government spending as a result. Last year saw a huge increase in tax income, which – together with inflation – will boost government debt levels further into safe territory. For 2023 and 2024, Ireland is expected to run a budget surplus which further solidifies its already very stable fiscal position.

The Irish economy in a nutshell (%YoY)

	2021	2022F	2023F	2024F
GDP	6.8	2.6	0.2	1.1
Private consumption	5.3	2.5	0.1	0.9
Investment	11.4	2.7	0.8	0.4
Government consumption	6.3	2.4	-1.1	0.0
Net trade contribution	-0.1	-0.4	0.2	0.3
Headline HICP	2.1	5.9	6.3	3.4
Unemployment rate (%, Eurostat definition)	7.9	7.3	7.4	8.0
Budget balance as % of GDP	-6.5	-5.5	-5.4	-5.4
Government debt as % of GDP	114	112	113	115

Source: Macrobond, all forecasts ING estimates

Finland: can it bounce back from recession as structural challenges mount?

The Finnish economy is set to undergo a milder economic winter than previously expected, but structural challenges will work against a swift recovery in 2023

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Sanna Marin has been prime minister of Finland since 2019

No vigorous bounce back in the making

The Finnish economy shrank in the third quarter of 2022 and is expected to currently be in recession. This is mainly because of the energy crisis and subsequent purchasing power squeeze. Thanks to the warmer winter weather Europe is experiencing, the impact of the energy crisis is smaller than initially expected, which means that a recession in Finland is likely to be rather mild. That means the big question for 2023 is how fast Finland can recover.

The Finnish economy is set to remain under strain over the course of 2023. A fast recovery seems unlikely as the current drivers of economic weakness are set to persist over the coming quarters. While inflation is expected to moderate during 2023, real wage growth is set to remain negative for quite some time to come as energy prices are expected to remain elevated. That will put pressure on consumption growth as purchasing power will remain squeezed.

Exporters continue to face a challenging environment

Exports are also set to remain under pressure in Finland as the main export markets are likely to experience mixed economic activity this year. Concerns about Germany and China remain significant, where weak recovery in Germany is likely to dampen external demand for Finnish products, while China remains a big uncertainty in terms of how it will recover from the current wave of Covid-19. Russia – traditionally one of the largest trade partners of Finland – is unlikely to return to that position given the sanctions in place.

In the meantime, it is not just the energy crisis and Russia that provide persistent headwinds for 2023. The housing market is also cooling off on the back of the aggressive ECB rate hikes as mortgage rates rise quickly. Home sales have been on the decline since the beginning of 2022 as rates started to increase. Prices have also started to correct with December showing a 3.4% year-on-year drop. On the back of this, building activity

has started to moderate. As rates are not expected to show a correction again, we expect the housing market to continue to have a dampening effect on economic activity over the course of 2023.

A robust labour market and government support dampen inflation impact

So no miracles are to be expected for 2023; a mild recession followed by a sluggish recovery. Still, there are positives to mention despite this environment. Like much of Europe, Finland has a very strong and resilient labour market at the moment, which is not expected to show a large surge in unemployment despite economic challenges. That means that labour shortages are likely to remain elevated in 2023 and beyond, which will keep wage pressures more significant than before the pandemic. While this is a concern from a competitiveness perspective, it also dampens the negative income impact of this winter's downturn.

From a government finance perspective, Finland has challenges ahead. Debt-to-GDP has fallen to 71.6% after peaking at 75.6% in early 2021 after government support during the pandemic caused spending to soar. The high inflation rate has been beneficial for government finances, but forecasts for 2023 and 2024 see government debt increasing again. Compensation measures for the energy crisis and increased defence spending are set to contribute to higher debt levels for Finland this year.

The Finnish economy in a nutshell (% YoY)

	2021	2022F	2023F	2024F
GDP	3.0	2.0	0.0	1.1
Private consumption	3.7	2.1	0.2	1.0
Investment	1.5	3.2	0.4	1.3
Government consumption	2.9	1.2	0.1	0.4
Net trade contribution	-0.2	-0.4	-0.3	0.1
Headline CPI	2.1	7.2	5.1	2.2
Unemployment rate (%))	7.0	6.8	7.1	7.0
Budget balance as % of GDP	-2.7	-1.5	-2.5	-1.9
Government debt as % of GDP	72.4	71.2	72.5	73.5

Source: Macrobond, all forecasts ING estimates

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