EUROZONE: ECONOMIC SPRING WILL COME, BUT SLOWLY

There is a broad consensus amongst forecasters that Eurozone quarterly growth in real GDP will gradually pick up over the year on the back of a further decline of inflation, cuts in official interest rates, investments in the energy transition and those related to NextGeneration EU. Foreign trade may also play a role. Survey data of the European Commission and S&P Global have improved since the autumn of last year but their level remains below the historical average. Based on historical relationships, their positive momentum -recent observations are better than those 3 months ago- increases the likelihood that GDP growth in the first quarter will be better than in the final quarter of 2023.

There is a broad consensus amongst economic forecasters that Eurozone quarterly growth in real GDP will gradually pick up over the year. The ECB's survey of professional forecasters published in January shows a slow recovery of economic activity throughout this year (see table)[1]. The December 2023 Eurosystem projections also expect an improvement[2]. The recently published European Commission's winter forecast mentions that *"prospects for the first quarter of 2024 remain subdued, but the conditions for a progressive acceleration of economic activity this year appear still in place.*[3]*"* Our own forecasts have a similar profile. Key drivers of the expected recovery are a further decline of inflation, cuts in official interest rates -which would improve the financing conditions- as well as investments in the energy transition and those related to NextGeneration EU. Ahead of the first policy easing by the ECB, the prospect of such a move can already support confidence of economic agents through a reduction in interest rate uncertainty -to be precise, fears of higher rates have disappeared- and through an easing of financial conditions. Moreover, a slide in a recent presentation of Isabel Schnabel of the ECB was entitled "*economy is bottoming out as peak of transmission may have been reached*[4]." This implies that tight monetary policy should be less of a headwind than before. Finally, the international environment may also play a positive role[5].

What do the data tell us? Many soft data -business and household surveys- are published earlier than hard data -activity, demand, employment- so the historical relationships between the two can be used to gauge whether there is already any evidence pointing in the direction of an improvement of the hard data. The European Commission's economic sentiment index (ESI) declined slightly in February (from 96.1 to 95.4). Looking at its components, industry sentiment recorded a marginal decline. Construction and particularly retail trade saw a bigger weakening. Consumer sentiment improved but services' sentiment dropped.

EUROZONE REAL GDP (CHANGE Q/Q IN %, NON-ANNUALISED)

	Q4 2023	Q1 2024	Q2 2024	Q3 2024	Q4 2024
ECB Survey of Professional Forecasters Q1 2024	0.0	0.1	0.3	0.3	
December 2023 Eurosystem staff macroeconomic projections	0.1	0.2	0.3	0.4	0.4
European Commission Winter forecast	0.0	0.2	0.3	0.4	0.4
BNP Paribas	0.0	0.1	0.3	0.4	0.4

EUROZONE: ECONOMIC SENTIMENT AND GDP

SOURCE: EUROPEAN COMMISSION, REFINITIV, BNP PARIBAS
DATA SINCE 1995 Q2. DATA FOR 2020 HAVE BEEN EXCLUDED

1 *Source: ECB, Survey of Professional Forecasters, January 2024*. It should be noted that the profile for quarterly growth is slightly lower than the previous survey (October 2023).
2 Source: ECB, Eurosystem staff macroeconomic projections for the euro area, December 2023 (europa.eu).
3 Source: *European Commission, European Economic Forecast, winter 2024, i*nstitutional paper 268, February 2024.
4 Source: ECB, *Has the fight against inflation been won?* Isabel Schnabel, Member of the Executive Board of the European Central Bank, Lecture on monetary policy and financial policy, Bocconi University, Milan, 23 February 2024. The speech provides model-based estimates of the impact of changes to short-term rate expectations between December 2021 and February 2024, and changes to expectations regarding the ECB's balance sheet between October 2021 and February 2024 on real GDP growth. The mean impact is -4.0% in 2023, -2.0% in 2024 and almost zero in 2025.
5 In commenting its December Eurosystem projections, the ECB mentioned an improved international environment as an additional factor.

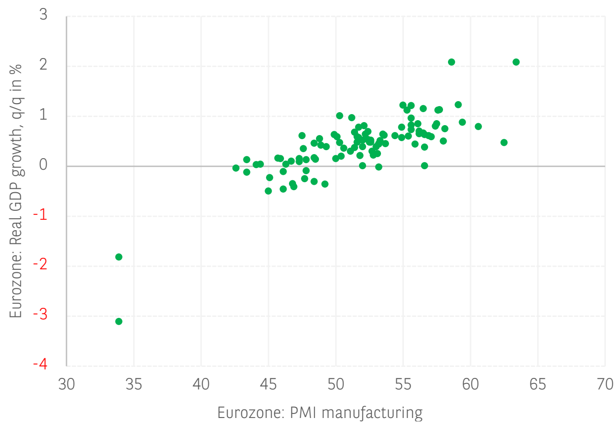
> The recovery should be very gradual. Against this background, the evolution of inflation remains key, through its impact on households' confidence and spending power, the cost base of companies and, most importantly, through its influence on the ECB's guidance and decisions.

Taking a slightly longer perspective, the ESI, after declining for several months, reached a low point in September and October last year at 93.9 and improved thereafter, reaching 96.4 in December, before weakening in January and again in February.

As shown in chart 1, considering that the ESI is still below its long-term average of 100, there is a risk of negative quarterly real GDP growth[6]. On the other hand, momentum has been positive: the average ESI for the latest 3 months is higher than for the previous 3 months. An alternative measure consists of comparing the latest reading with that 3 month earlier. Despite its recent softening, the February ESI is still higher than the one 3 months ago, so on this measure momentum is still positive. Does a better momentum of the survey data point towards a better momentum of real GDP growth? If this were the case, it would point to better first quarter GDP growth compared to the final quarter of 2023. History tells us that this has tended to be the case: when the ESI in the final month of a quarter was higher than at the end of the previous quarter, real GDP growth in the same quarter was higher than in the previous quarter in 60% of cases[7]. Considering that real GDP growth (q/q) has been positive in 51% of cases, looking at ESI momentum when estimating quarterly GDP growth should add value.

The S&P Global purchasing managers' index (PMI) is another important survey of business sentiment. Momentum -defined as the change in the average for the latest 3 months versus the 3 previous months- has been positive, both for the manufacturing and the services sector but one should keep in mind that we are starting from a low base, particularly in manufacturing. Chart 2 shows that when the manufacturing PMI drops below 50, the likelihood of negative quarter-on-quarter GDP growth increases[8]. In this respect, the February reading of 46.5 is sobering. Does PMI momentum help in assessing whether real GDP growth in a given quarter might be higher than in the previous quarter? The answer is clearly positive: when the manufacturing PMI in the final month of a quarter was higher than its value 3 months earlier, real GDP growth has been higher than in the previous quarter in 64% of cases. Considering the latest value of the manufacturing PMI is well above that in December (46.5 versus 44.4), it seems likely that the reading in March will be higher than in December, implying positive momentum. This would point towards a high likelihood of first quarter GDP growth being better than in the previous quarter.

EUROZONE: MANUFACTURING PMI AND GDP



SOURCE: S&P GLOBAL, REFINITIV, BNP PARIBAS.
DATA SINCE 1997 Q3. DATA FOR 2020 HAVE BEEN EXCLUDED

To conclude, when describing the economic outlook, it's tempting to use the metaphor that spring is in the air considering that it's early March, that in terms of activity and demand, the last months have resembled an economic winter -basically a stagnation of real GDP- and that sentiment data have improved in recent months, despite the recent weakening of the European Commission's index. However, much like the soft winter -no recession in the Eurozone-, spring looks soft as well and the recovery should be very gradual. Against this background, the evolution of inflation remains key, through its impact on households' confidence and spending power, the cost base of companies and, most importantly, through its influence on the ECB's guidance and decisions.

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6 The chart excludes the data for 2020 considering that the Covid-19 pandemic caused huge swings in the survey and GDP data.
7 Data for 2020 have been excluded. The results for this momentum measure are better than those based on the quarterly average of the ESI.
8 The manufacturing PMI is used rather than the composite PMI -a weighted average of the manufacturing and services surveys- because longer time series are available.