

Watch out for a relapse

Economic activity in the eurozone is showing clearer signs of weakening, and our Nowcast now foresees a stagnation in real GDP in the second quarter of 2023. Retail sales were stable during the first two months of Q2. Survey data also offers little reassurance and seems to indicate a possible relapse in activity in Q3 which we currently estimate at -0.1% q/q: the composite PMI index deteriorated significantly in June, falling below the threshold of 50, to 49.9. The manufacturing sector index fell further into contraction and is now at levels comparable to those seen during 2020, in the midst of the pandemic.

Although a lower gap in inflation between Euro member countries is expected in the second half of 2023, the divergence was still significant in June. Average harmonised inflation in the eurozone slowed to 5.5% in June, compared to 6.1% the previous month. However, almost 9 points still separate Luxembourg, Spain and Belgium, where the inflation rate fell below 2%, from Slovakia, where the rise remains above 11%. In the eurozone, only services recorded higher inflation in June (increasing from 5.0% to 5.4%). The latter slowed but remained very high in “food, alcohol & tobacco” (11.7%) while deflation in energy prices intensified (-5.6%).

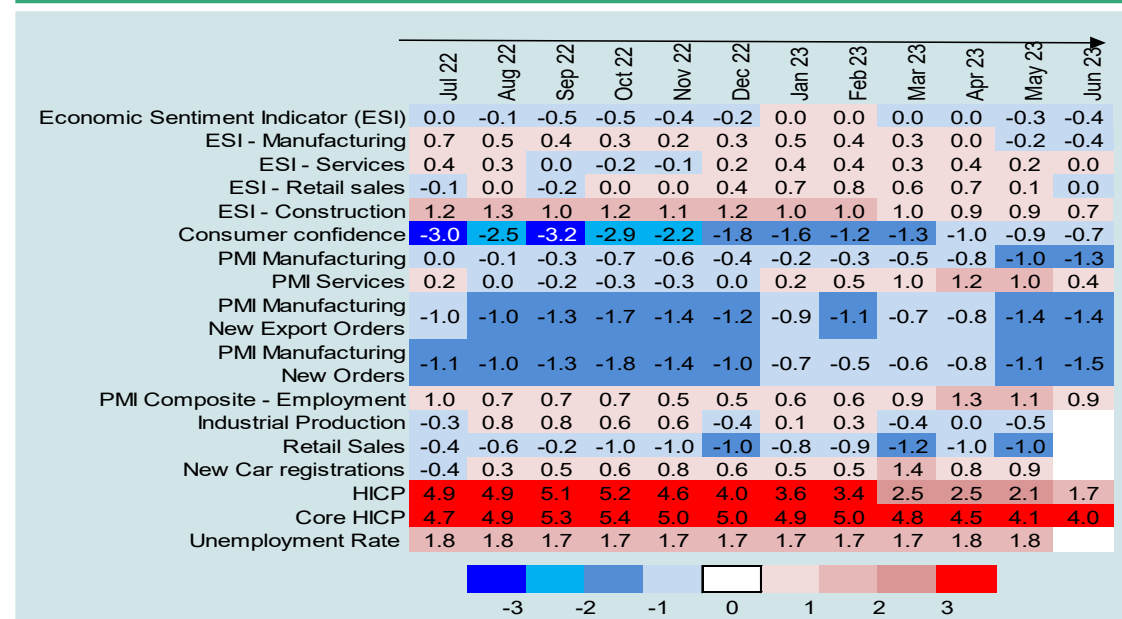
As the Bank of Italy’s current governor, Ignazio Visco, pointed out, the downward trend in energy prices should have knock-on effects on the prices of other consumer items¹. Nevertheless, the scale and speed of this phenomenon will remain conditional on the development of other factors, particularly wage growth. This strengthened significantly during the first quarter (+4.3% year-on-year), according to the ECB’s indicator, which reflects the results of collective bargaining.

With an unemployment rate at its lowest ever level in May, at 6.5%, greater increases in wages are conceivable, which would delay a lasting drop in inflation in the eurozone, and, in particular, a return to the 2% target. We therefore expect the deposit rate to rise again at the monetary policy meeting on 27 July before a final increase in September, bringing the terminal rate to 4.0%.

Guillaume Derrien (completed on 19 July 2023)

1 See *ECB’s Visco Says Inflation May Drop More Quickly Than Forecast*, Bloomberg, 18 July 2023.

Eurozone: economic indicators monthly changes



The Indicators are all transformed into “z-scores”, i.e. deviations from the long-term average value (expressed in standard deviation), the average of which is zero (except for the PMI/ISM indices where the average is 50, the threshold between the expansion zone and the contraction zone of the activity). Positive (negative) values indicate the number of standard deviations above (below) the mean value.
Reading note: the red colour indicates dynamic activity, high inflation and low unemployment, the blue colour indicates slower activity, low inflation and high unemployment.

GDP growth

Actual		Carry-over	Nowcast	Forecast		Annual forecasts (y/y)				
Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	2022 (observed)	2023	2024		
0.8	0.4	-0.1	-0.1	0.2	0.0	0.2	-0.1	3.5	0.4	0.6

See the [Nowcast methodology](#). Contact: [Tarik Rharrab](#)
Source: Refinitiv, BNP Paribas