EUROZONE

THE HALT IN GROWTH BECOMES CLEARER

Eurozone company surveys (PMI, European Commission) continued to deteriorate throughout the summer, although a slight improvement was observed in September for the PMI. The rise in policy rates by 25 basis points in September – the last one according to our forecast – will amplify this phenomenon. We do not expect a recession in the euro zone as a whole in 2023, but moderate growth at 0.5%, mainly due to a favourable carry-over effect in 2022. After a slightly positive first semester, eurozone activity is likely to stall in the second semester. Significant growth differentials are expected between the Member States.

According to our forecasts, eurozone activity is likely to stall in the second half of 2023, under the effects of a contraction in GDP in Germany (Q3 and Q4) and France (Q3 only) which should be offset by growth in Italy and, above all, Spain. Furthermore, hourly labour productivity in the eurozone fell in the second quarter (-1.0% y/y): given the significant increase in hourly compensation (+5.4% y/y), the unit labour cost (ULC) rose sharply in Q2 by +6.5% y/y. The largest ULC increases occurred in the manufacturing and energy sectors (+7.6% y/y), as well as in the 'commerce, transport, accommodation and food services' component (+8.2% y/y). Faced with a deteriorating economic climate, and an above-inflation rise in ULC, the labour market should lose momentum. However, the extent of this decline and an increase in the unemployment rate should be relatively limited given persistent recruitment difficulties. The unemployment rate remained at a record low of 6.4% in September.

In the wake of the pandemic, corporate activity within the monetary union was initially limited, mainly by supply constraints (equipment, labour). These constraints, which are reducing slightly, remain significant, and are now supplemented by a weakening in demand. There are multiple signs of slowing activity: the European Commission's economic sentiment index reached its lowest level in three years in September; M3 money supply fell back into negative territory on an annual basis in July for the first time since spring 2011 and fell further in August (-1.1% y/y); mortgage and corporate loans slowed sharply to 0.5% y/y in August.

The tightening in credit should limit private investment growth, despite the expected support from the Next Generation EU programme, most of which is still to come. At the end of September, the European Commission published an update on the programme's progress[1]. On 1 September 2023, EUR 153.4 billion, i.e. only 20% of the fund, had been paid to Member States, two-thirds in the form of subsidies (EUR 106.3 bn) and one-third in the form of loans (EUR 47.1 bn)[2].

Inflation slowed sharply in September, moving from 5.2% y/y in the previous month to 4.3% according to Eurostat's preliminary estimate. Although another slowdown is expected in the autumn, its scope could be more limited than expected, mainly due to the upturn in oil prices since this summer, whose effects on the energy component are already clearly visible (+4.7% cumulatively over the August-September period[3]). Core inflation has also dropped since its peak in March this year, falling from 5.7% to 4.5% in September. The crossover of inflation and wage curves, expected in the second half of the year, is likely to limit a further fall in inflation. However, it will allow real wages to rise slightly after an uninterrupted fall of almost two and a half years. The indicator of negotiated wages, calculated by the ECB, rose 4.3% y/y in Q2, the same pace as in the previous quarter.

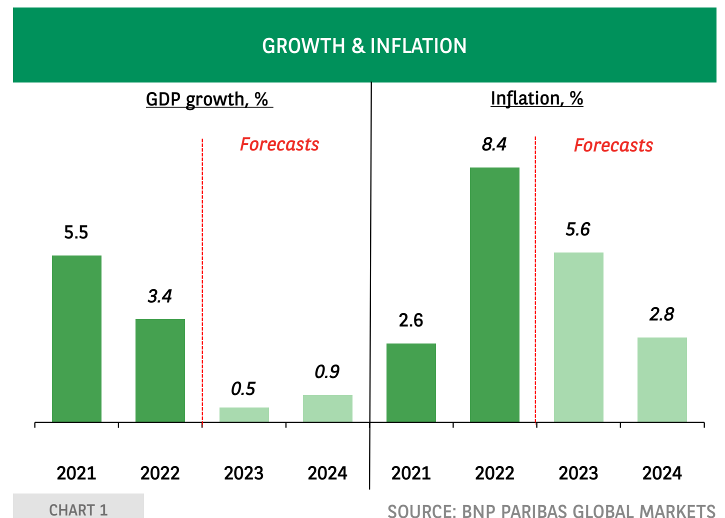

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

National authorities have taken notes of the economic slowdown and some have downgraded their growth forecasts for 2023 (particularly Italy and France). Nevertheless, fiscal support will remain significant, and the trajectory to reduce public deficits has been reduced in France and Italy. A return to below the 3% GDP target has been pushed back by one year: it would now be reached in 2026 for Italy and 2027 for France, respectively. All Member States will need to submit their budget plans to the European Commission by 15 October. The year 2024 will also mark the end of the suspension of the Stability and Growth Pact, and the introduction of new public finance management criteria. Last April, the European Commission presented the outlines of a new system, which all Member States will have to discuss and endorse by the end of the year. Although we do not anticipate any further interest rate hikes by the ECB, the gradual withdrawal of fiscal support will constitute an additional growth-limiting factor in the euro zone in 2024.

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1 OM_2023_545_1_EN_0.pdf (europa.eu)
2 Countries that have applied for loans so far are Italy (EUR 37.9 billion), Greece (EUR 5.3 billion), Romania (EUR 2.7 billion), Portugal (EUR 1.1 billion) and Cyprus (EUR 26 million).
3 HICP measurement for the euro zone.