Progressing despite near-term hurdles

- **The euro area economy experienced a solid first half of the year, achieving decent growth after a year of stagnation. Recent indicators, however, have cast doubts on the sustainability of this growth momentum, particularly in the manufacturing sector.**
- **We predict growth will continue, driven by a strong labour market and rising real incomes that bolster consumer spending in the coming year, but we see downside risks to the near-term outlook.**
- **The disinflationary process in the euro area is still on track, albeit some slowdown has been observed over the summer owing to persistent high services inflation that keeps underlying inflation elevated. Combined with normalizing goods inflation, we expect only a gradual decline in core inflation. We forecast that headline inflation will stabilize close to the 2% target in the second half of 2025, but the final path is set to be bumpy.**
- **We expect the ECB to deliver two more cuts of 25bp in 2024, followed by three in 2025. This means a terminal rate of 2.50% at year-end 2025, due to the need to keep a restrictive monetary policy stance.**

Important disclosures and certifications are contained from page 3 of this report.

		Forecast	
	2023	2024	2025
GDP Growth	0.5%	0.7% (0.7%)	1.2% (1.3%)
Inflation	5.4%	2.4% (2.4%)	2.1% (2.1%)
Unemployment	6.5%	6.5% (6.5%)	6.6% (6.6%)
Policy rate*	4.00%	3.25% (3.50%)	2.50% (2.75%)

Paranthesis are the old projections (From June 2024)
**End of period*
Source: Danske Bank, Eurostat, ECB

The euro area economy experienced a solid first half of the year, achieving decent growth after a year of stagnation. This positive trend was primarily supported by the service sector and the economies in Southern Europe, while the manufacturing sector and Germany faced challenges. Recent indicators, however, have cast doubts on the sustainability of this growth momentum, particularly due to weakness in the manufacturing sector. Global industrial activity has slowed down, and foreign demand looks frailer. As a result, we estimate that the near-term growth prospects have weakened slightly since our last forecast in June and see downside risks to the projections for 2024. Nonetheless, we still predict positive, but below trend, growth rates in GDP this year and next year, driven by private consumption and service providers. The labour market has moderated lately but overall remains solid which together with rising real incomes should bolster consumer spending. We see risks to the growth outlook for 2025 as balanced since we expect global central banks to gradually dial back the level of monetary policy restrictiveness and as consumption could increase more than expected thanks to current high savings.

The disinflationary process in the euro area is still on track, albeit some slowdown has been observed over the summer owing to persistent high services inflation

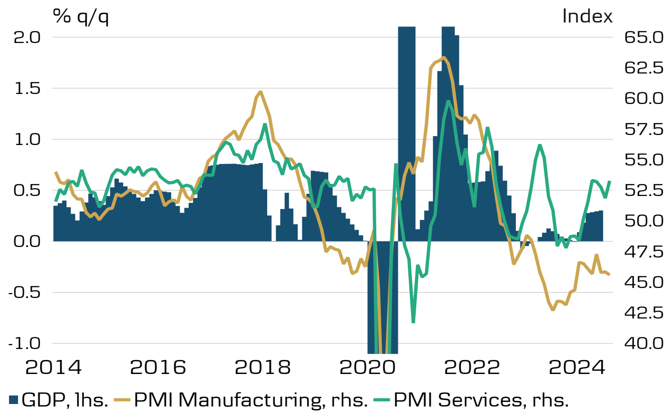
Rune Thyge Johansen, Analyst at Danske Bank

The disinflationary process in the euro area is still on track, albeit some slowdown has been observed over the summer owing to persistent high services inflation. The most recent momentum in services inflation remains strong especially due to domestically driven inflation on the back of elevated wage growth. However, the overall trend for inflation is pointing lower as sellers have scaled back price increase expectations, and wage growth has come down more than expected. Momentum in energy and food inflation is well-behaved and should continue to be so as supply chains normalise further. Hence, we forecast that headline inflation will stabilize close to the 2% in the second half of 2025, but the path towards the 2% target is set to be bumpy. Meanwhile, after a prolonged period of stability, goods inflation is slowly rising to normal levels, leading us to expect only a slow decline in core inflation. The risks assessment of our inflation outlook is tilted to the upside due to the potential of stronger-than-expected wage growth and energy prices.

We expect the ECB to deliver two more 25 bp cuts in 2024, in September and December, respectively, followed by three more in 2025, bringing the terminal rate to 2.50% in 2025. The call reflects a risk management exercise for the ECB looking at the totality of data where recent softening in growth and the labour market makes up for the still strong domestic inflation. This has meant that while our baseline outlook for inflation is broadly unchanged in our forecast horizon, the incoming data through the summer has removed some topside risk to inflation through easing growth and labour markets. Hence, we expect the ECB to be sufficiently confident in inflation returning to 2% to continue lowering the policy rate, and we see balanced risks to our ECB profile.

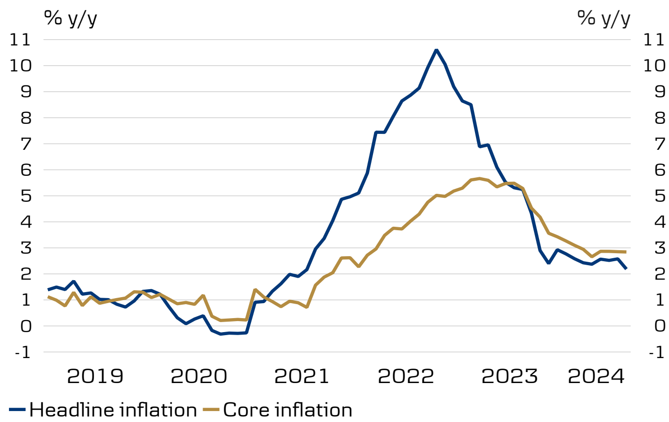
The outlook for the German economy is weak as the heavy reliance on manufacturing and weakness in construction drags down growth. Industrial exports in Germany are challenged by relatively higher energy costs compared to competitors. Yet, private consumption and the service sector should support growth, so we expect economic output to expand slightly. However, the long-term growth outlook for the economy stays weak due to headwinds from a more austere fiscal policy and a shrinking workforce.

Latest growth indicators have cast doubts on the sustainability of the recent growth momentum



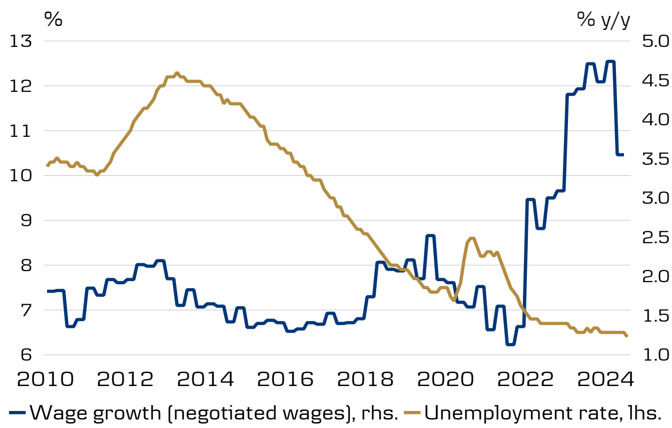
Source: S&P Global, Macrobond Financial

After significant declines, inflation remains sticky



Source: Eurostat, Macrobond Financial

The labour market is strong and wage growth is easing



Source: Eurostat, ECB, Macrobond Financial

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