

Euro Area Macro Monitor

Conflicting signals

- **After expanding by 0.2% q/q in the first quarter, the euro area economy started Q2 on a stronger footing than one could have feared**, in light of renewed supply disruptions from the Ukraine war and Chinese lockdowns as well as weakening demand prospects from rising prices. While services activity continued to build momentum during April after the lifting of pandemic restrictions and increased spending on travel and recreation, growth in manufacturing output nearly stagnated as bottlenecks, rising prices and heightened uncertainty took their toll. German industry still presents the epicentre of the slowdown, with new orders contracting for the first time in two years. Another worrisome development is the indication that some firms are front-loading purchases in anticipation of further price rises, suggesting that inflation expectations are still adjusting upward. At the same time consumer confidence fell sharply during April, in a sign that spending might face increasing headwinds in the coming months.
- **Despite energy price inflation slowing down after commodity prices have stabilized, headline inflation reached another new record high of 7.5% in April**, with core inflation surprising significantly on the upside at 3.5%. The continued building of underlying inflation pressures leaves little room for complacency from ECB and further upside risks loom from food prices in the coming months and tentative signs of wage growth picking up. With the possibility of further disruptions to Russian gas and oil supply looming as the EU readies another sanctions package, the risks to euro inflation remain firmly on the upside in our view.
- **With the economy holding up and inflation reaching ever new record highs, a growing number of ECB hawks are advocating a faster policy normalisation pace**, especially amid signs of de-anchoring inflation expectations, with market- and survey-based measures now standing above the 2% goal. ECB President Lagarde struck a fairly dovish tone at the April meeting (see *ECB Review - No rush to tighten policies - September in play*, 14 April), reiterating the game plan to end QE in Q2 and stressing flexibility and data-dependency. However, a range of Governing Council members have since sent a message of urgency to the market, mentioning the possibility of a hike already in July this year, which is now also our base case. Markets have now priced in a total of 200bp of rate increases until end-2023, but with growth challenges mounting in 2023, we remain sceptical about ECB's ability to deliver on these hawkish expectations.
- **Emmanuel Macron won the presidential election run-off against Marine Le Pen**, making him the first incumbent to win re-election in France since Jacques Chirac 20 years ago. However, during his second term Macron is facing increasing headwinds, both from the economy and political fragmentation. With only 59% of voters endorsing him for a second term (compared to 66% in 2017), he has to govern a divided country and the weaker mandate could make it challenging for Macron to push ahead with his ambitious reforms of the pension, health and education system. To what degree he can implement his plans will depend on parliamentary elections held on 12 and 19 June.

Key points

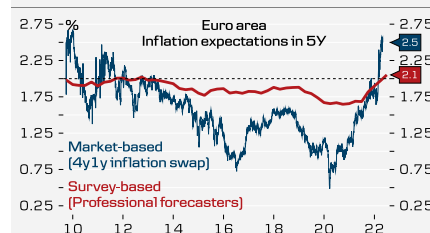
- Economic momentum is holding up better than expected, but vulnerabilities still lurk
- Signs of de-anchoring inflation expectations worry ECB hawks
- A more challenging second term awaits French President Macron

Growing manufacturing headwinds



Source: Markit, Macrobond Financial, Danske Bank

Signs of de-anchoring inflation expectations worry ECB hawks



Note: Past performance is not a reliable indicator of current or future results.

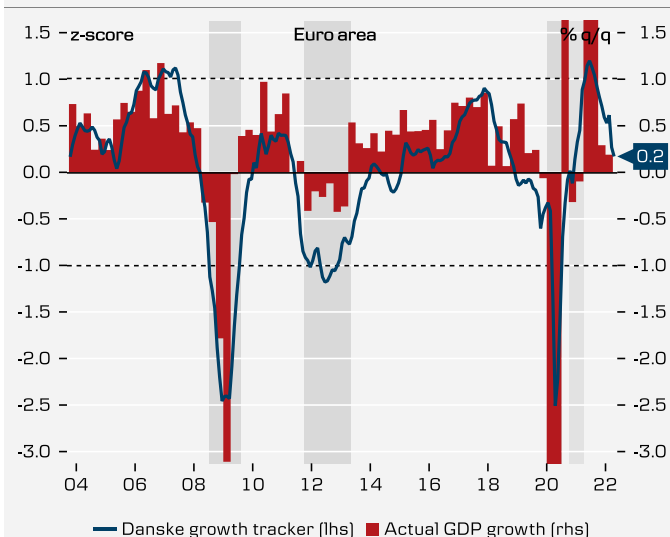
Source: ECB, Bloomberg, Macrobond Financial, Danske Bank

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The Danske euro area growth tracker

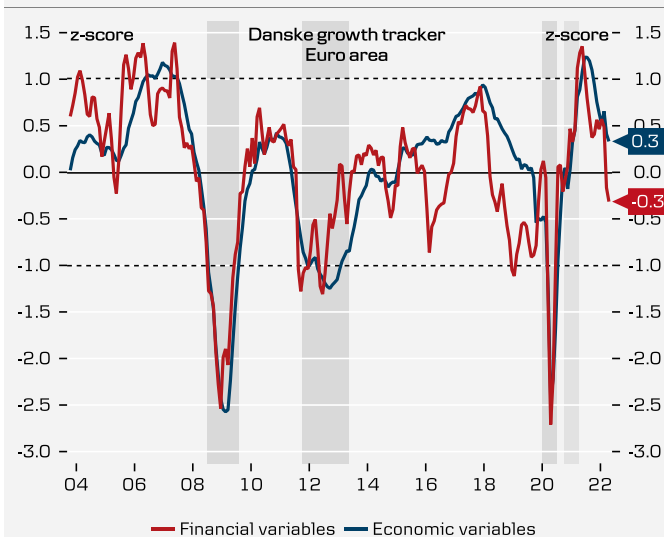
Our growth tracker eased to a value of 0.2 in April, reflecting further declines in economic variables such as consumer confidence and PMIs. Financial variables continue to paint an even more gloomy picture, with risk sentiment under pressure amid rising yields and volatile equity markets. In light of the growing headwinds for the euro area economy, our growth tracker traffic light has switched into 'red', signalling an elevated recession risk.

Growth tracker and actual GDP growth



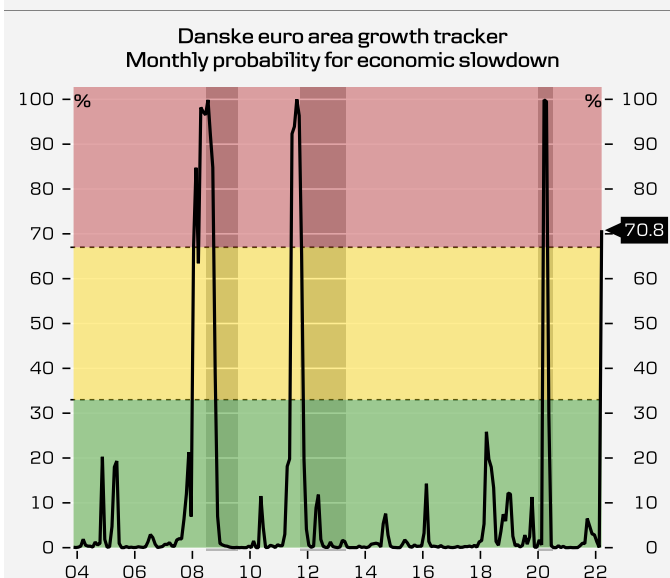
Note: Shaded area indicates historical recessions
Source: Macrobond Financial, Danske Bank

Growth tracker: financial and economic variables



Note: Shaded area indicates historical recessions
Source: Macrobond Financial, Danske Bank

Monthly probability of economic slowdown



Note: Shaded area indicates historical recessions
Source: EViews, Macrobond Financial, Danske Bank

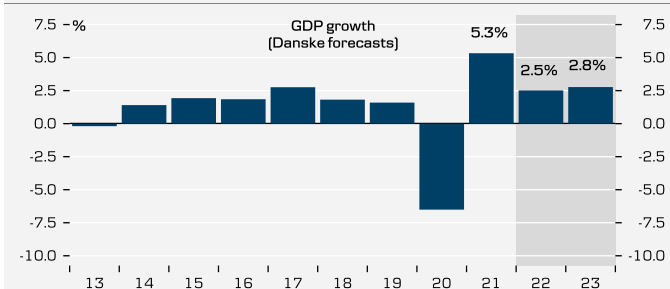
Danske growth tracker decomposition

	April 2022
Economic variables	0.3
Unemployment	1.7
EuroCOIN	1.0
Composite PMI	0.7
Capacity utilisation	0.6
Real M1 growth	0.6
European sentiment indicator	0.5
Profit growth	0.5
OECD CLI	0.3
Credit growth	0.3
PMI order-inventory balance	0.1
ZEW	-0.1
Consumer confidence	-2.1
Financial variables	-0.3
Euro surprise index	0.6
Corporate vs. gov. bond yield	-0.3
Eurostoxx50	-0.4
Sentix	-1.2

Source: Danske Bank

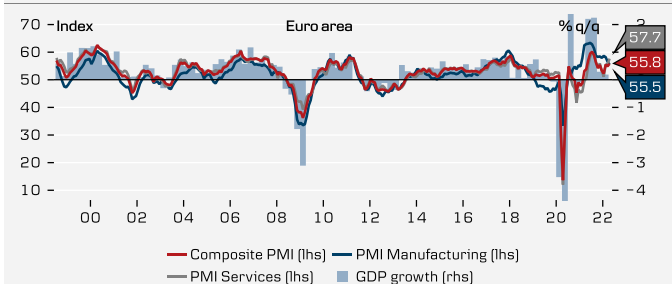
Euro area

GDP growth forecasts



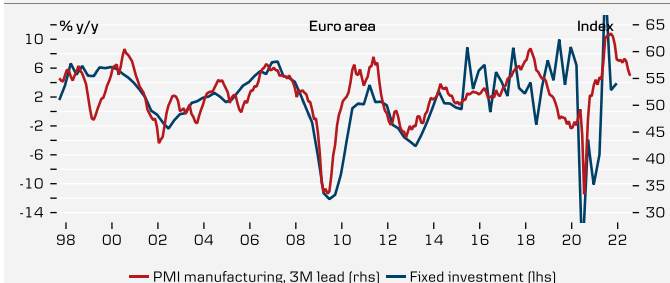
Source: Macrobond Financial, Danske Bank forecasts

PMI and GDP growth



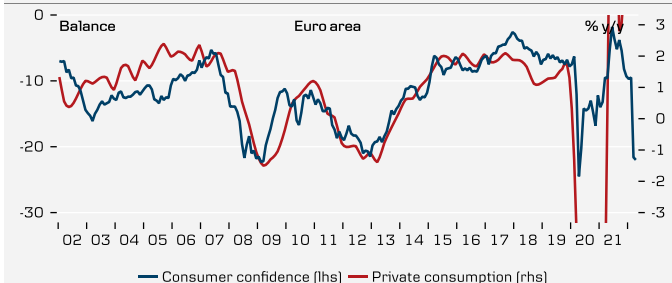
Source: Macrobond Financial, Danske Bank

Manufacturing sentiment and investments



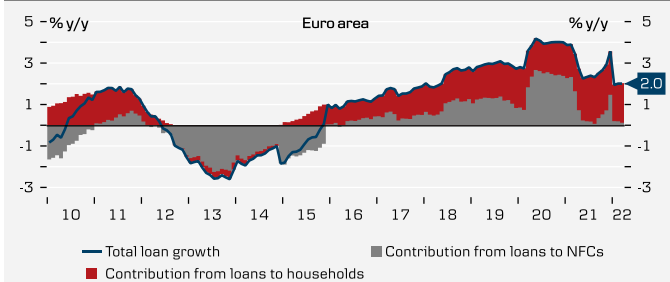
Source: Macrobond Financial, Danske Bank

Consumer confidence and private consumption



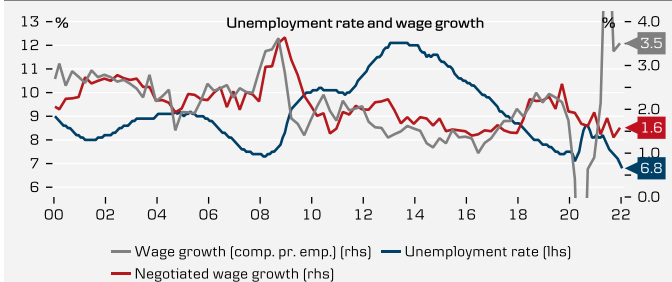
Source: Macrobond Financial, Danske Bank

Credit growth



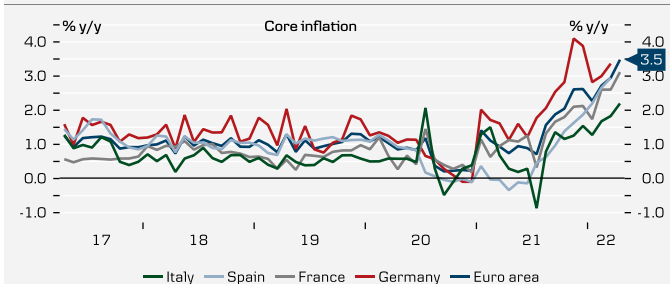
Source: Macrobond Financial, Danske Bank

Unemployment and wage growth



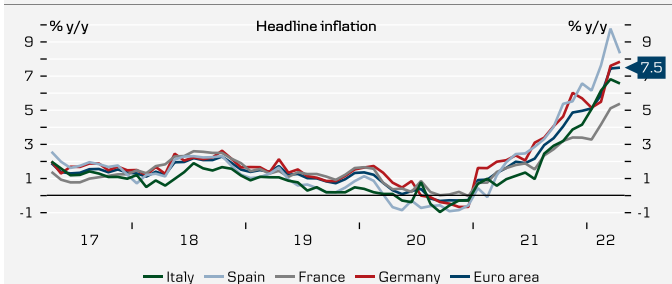
Source: Macrobond Financial, Danske Bank

Core inflation



Source: Macrobond Financial, Danske Bank

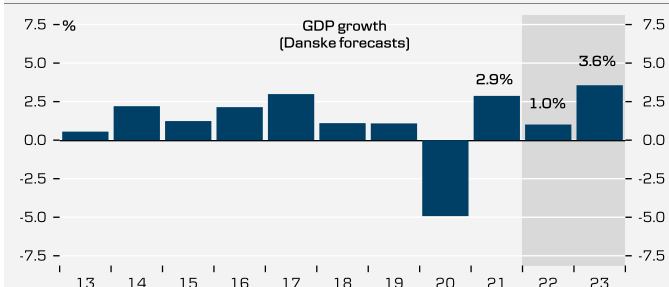
HICP inflation



Source: Macrobond Financial, Danske Bank

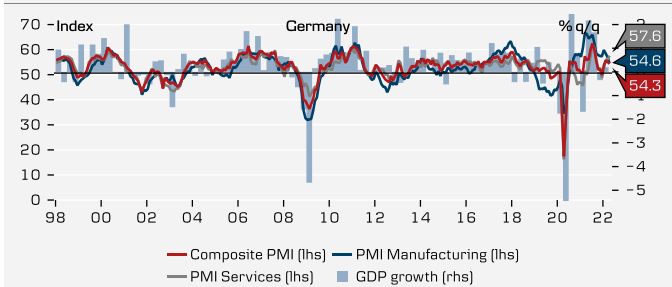
Germany

GDP growth forecasts



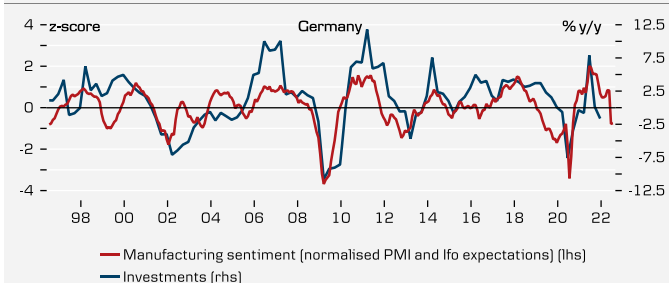
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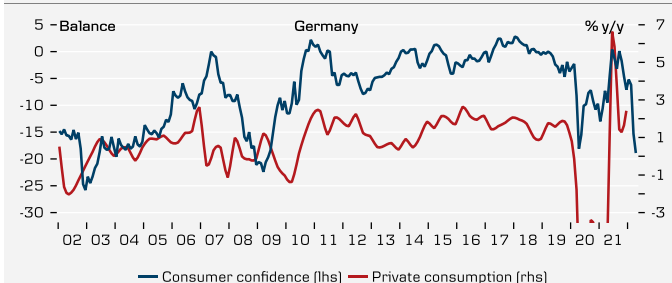
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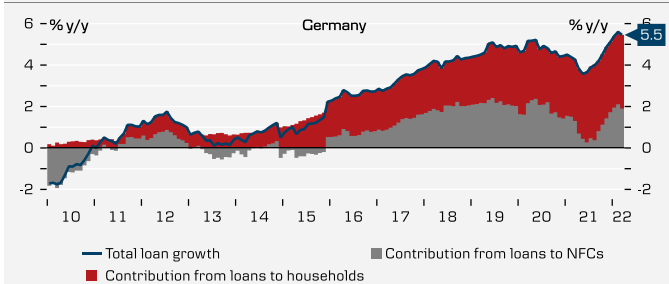
Source: Macrobond Financial, Danske Bank

Consumer confidence and private consumption



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Credit growth



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Unemployment and wage growth



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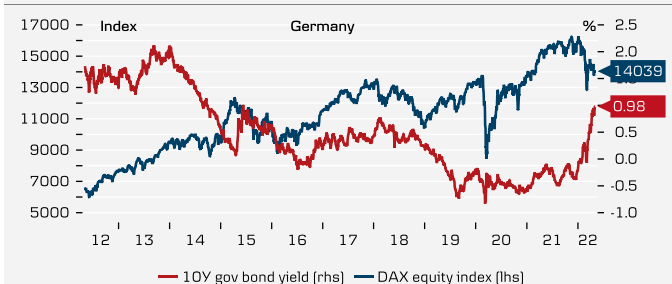
Google mobility trends in retail & recreation



Source: Google Mobility, Danske Bank

Note: The above shows mobility trends for places such as restaurants, cafes, shopping centres, theme parks, museums, libraries and cinemas

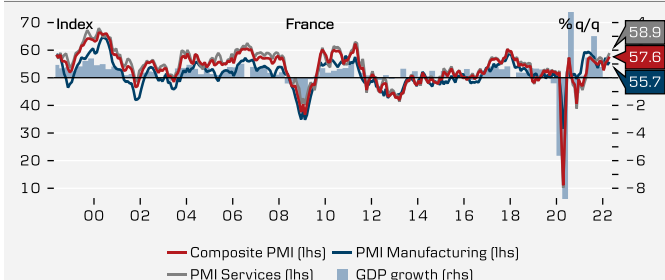
Financial markets



Source: Macrobond Financial, Danske Bank

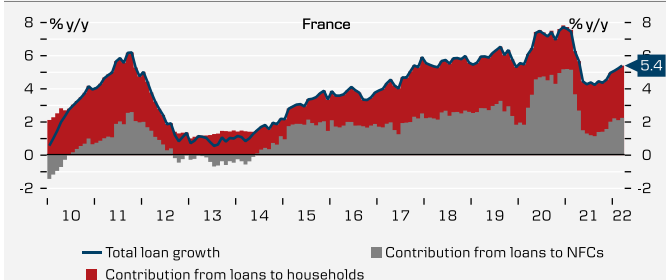
France

PMI and GDP growth



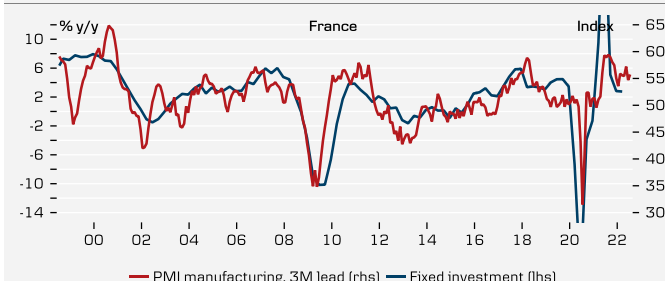
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Credit growth



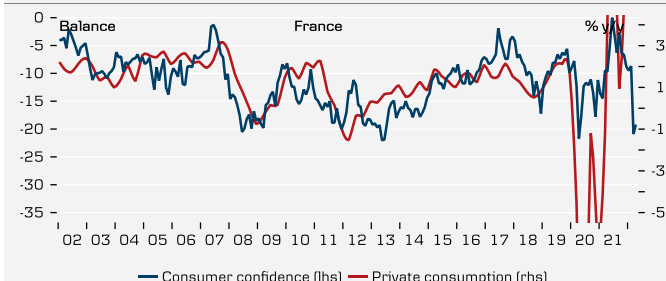
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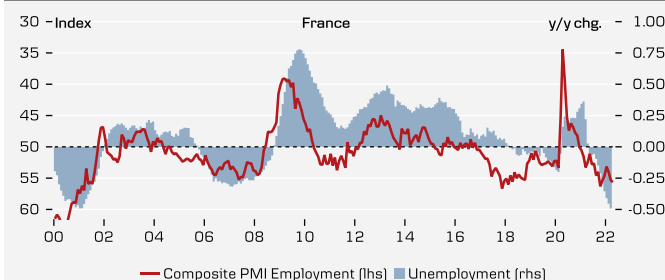
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Consumer confidence and private consumption



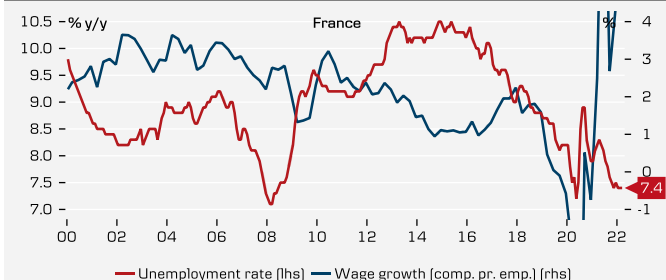
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Unemployment and PMI



Source: Macrobond Financial, Danske Bank

Unemployment and wage growth



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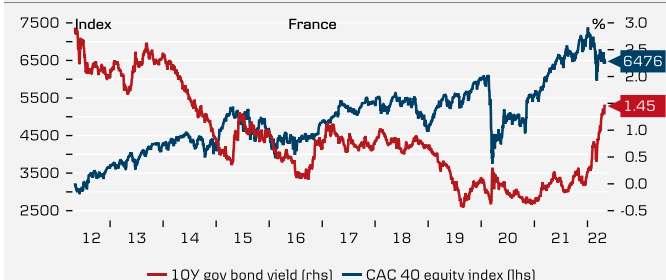
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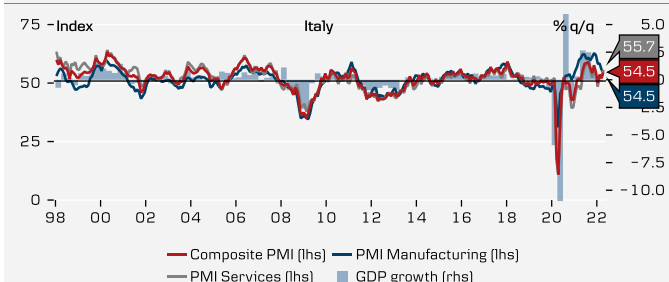
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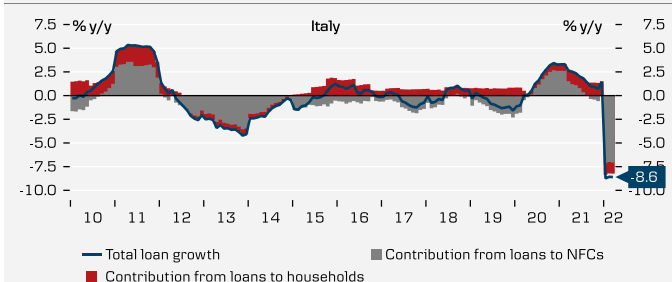
Italy

PMI and GDP growth



Source: Macrobond Financial, Danske Bank

Credit growth



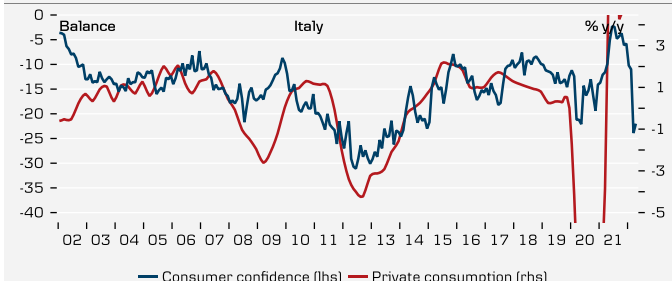
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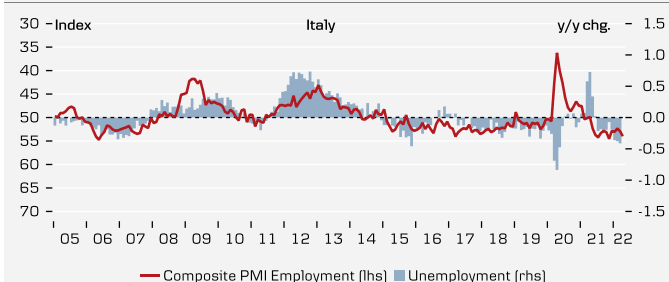
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Unemployment and PMI



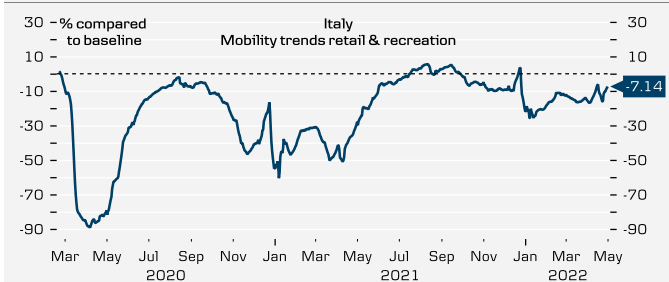
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Unemployment and wage growth



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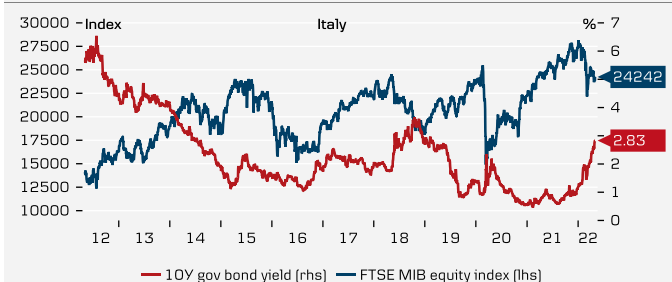
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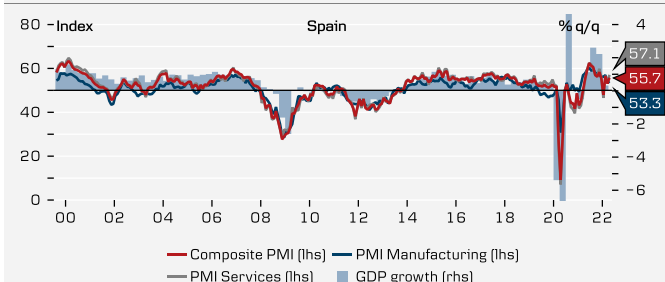
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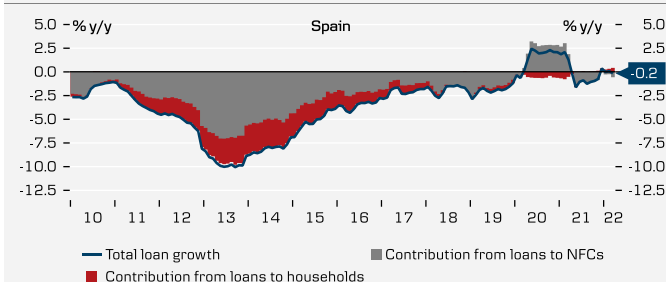
Spain

PMI and GDP growth



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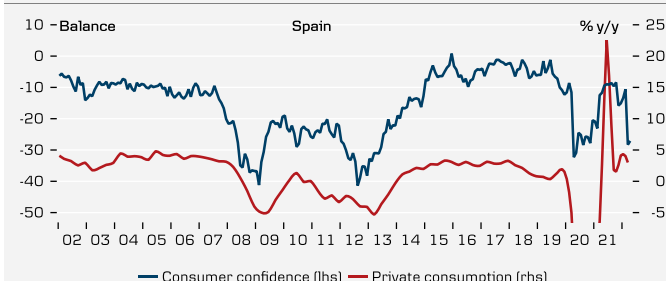
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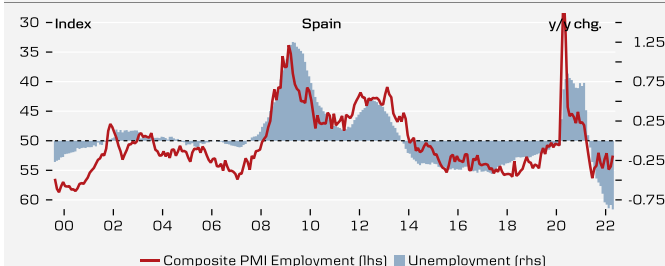
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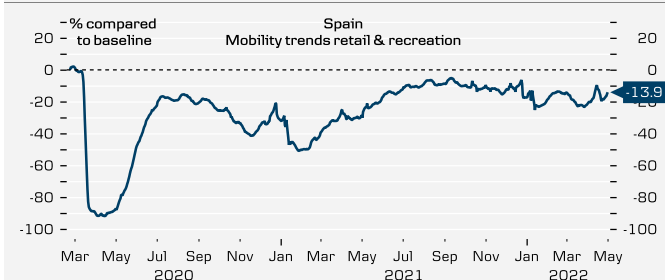
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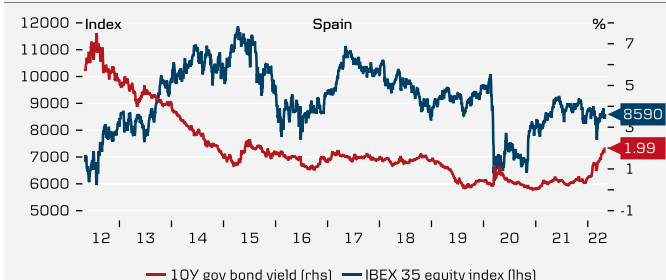
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Report completed: 5 May 2022, 14:00 CET

Report first disseminated: 5 May 2022, 14:15 CET