

Euro Area Macro Monitor

Chilling prospects

- **Imminent recession fears abated somewhat during November, as sentiment rebounded from subdued levels.** Record low unemployment, *EUR 600bn of fiscal support* and a drop in energy prices from their autumn peaks all helped to lighten the mood of consumers and firms. So has Europe's crisis ended before it even started? We do not think so. The current economic 'strength' is largely a holdover from the past. Manufacturing output continues to receive tailwind from high order backlogs and easing supply constraints. Households still benefit from EUR 800bn of 'excess' savings accumulated during the pandemic and government intervention that mitigates the energy shock.
- **However, cracks have started to appear.** Retail sales declined 1.8% m/m in real terms during October, the biggest fall since December 2021. Households face headwinds not only from higher energy bills, but also rising interest rates. The energy crisis is far from over and government subsidies vary significantly across EU countries, as agreement on an EU-wide gas price cap remains elusive. An *Ifo survey* showed that 75% of German manufacturers have cut back on gas usage without curtailing production, however, 40% also said that more energy savings will necessitate production cuts. Overall, we think a double dip recession is a real risk in the euro area (see *Big Picture Euro area - Double dip recession*, 28 November) and challenging times lie ahead especially for Germany's economy (see *Big Picture Germany - 'Zeitenwende'*, 28 November).
- **On the face of it, the November flash HICP figures brought a welcome decline in headline inflation** from 10.6% to 10.0%. However, with core inflation holding steady at 5.0%, the evidence for a similar peak in underlying inflation pressures was less clear-cut. Firms continue to pass-on higher input costs to consumers and in spite of an approaching recession, we expect this process of cost-push inflation to extend into 2023. We forecast euro area HICP inflation to average 7.2% in 2023 and 2.9% in 2024, while core inflation will return to the ECB's target only in H2 24 (read more in *Euro inflation notes - A 'sticky' problem*, 30 November). For ECB, the stabilization in core inflation paired with the weakening growth outlook might be just enough evidence to slow the hiking pace to 50bp in December. However, we expect it to continue guiding for further rate hikes ahead, paired with a reduction of the balance sheet (QT), as **'stickily' high core inflation could remain a concern for ECB for some time yet.**
- **The European Commission presented a first blueprint how to reform EU fiscal rules**, which foresees individual member states getting a bigger say in their debt reduction plans, with extra time granted for justified investments and structural reforms, while also strengthening enforcement. We think the proposal is a step to a right direction, but we do not expect the new rules to reduce risks relating to public finances any time soon and some countries like Germany are sceptical about the reform (read more in *EU fiscal rules - An evolution rather than a revolution*, 21 November). **US-EU trade relation have also seen a deterioration in recent weeks**, after the adoption of the US Inflation Reduction Act. Gaining a leading position in the green transition race remains key for escaping the current 'stagflationary' dynamics that have captured Europe. Hence, the stakes for the EU to assert its position are higher than in previous transatlantic trade spats (read more in *Euro macro notes - Transatlantic ties are in for a chill*, 16 November).

Key points

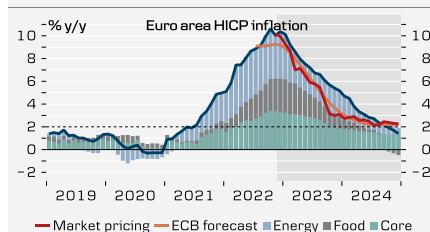
- Sentiment has stabilized, but recession still looms large
- 'Stickily' high core inflation could remain a concern for ECB for some time yet

Unemployment reaches ever new record lows



Source: Eurostat, Macrobond Financial, Danske Bank

'Stickily' high core inflation could remain a concern for ECB for some time yet



Source: Eurostat, ECB, Macrobond Financial, Danske Bank

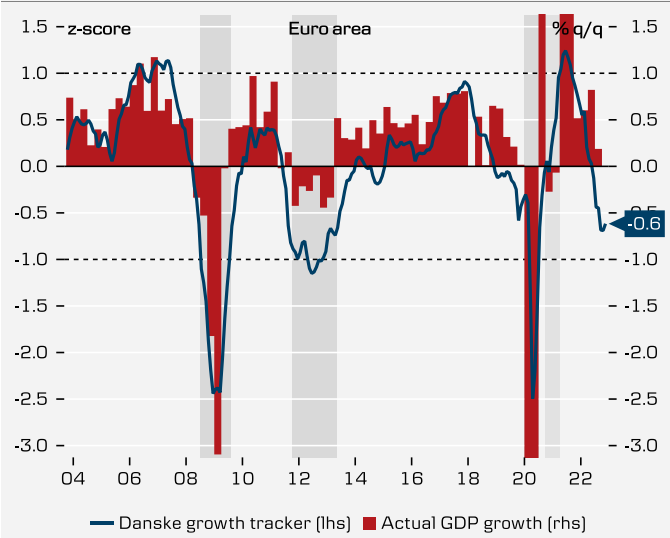
Note: Past performance is not a reliable indicator of current or future results.

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The Danske euro area growth tracker

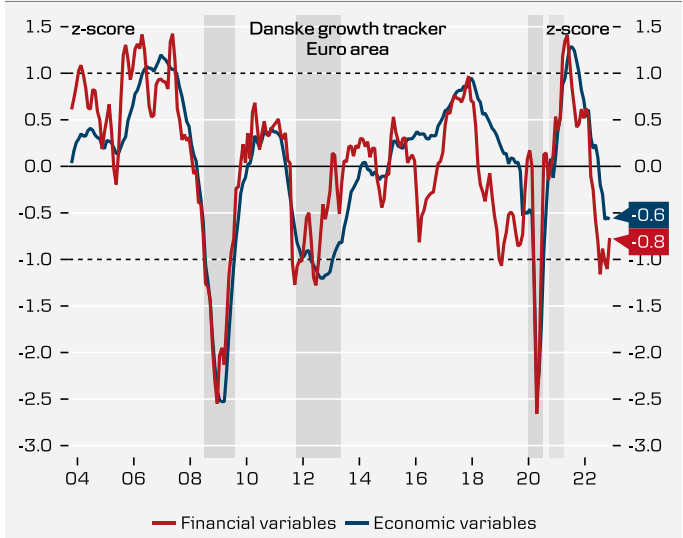
Our growth tracker rebounded from -0.7 to -0.6 in November, thanks to an uptick in the financial variables on the back of constructive market sentiment and positive economic surprises during November. Economic variables paint though a more nuanced picture, with improvement in consumer confidence or ZEW expectations countered by further declines seen in PMI order-inventory balances or the EuroCOIN indicator. While our growth tracker does not yet signal that the euro area has entered recession territory (-1 or below), our traffic light suggests that the recession risk remains elevated.

Growth tracker and actual GDP growth



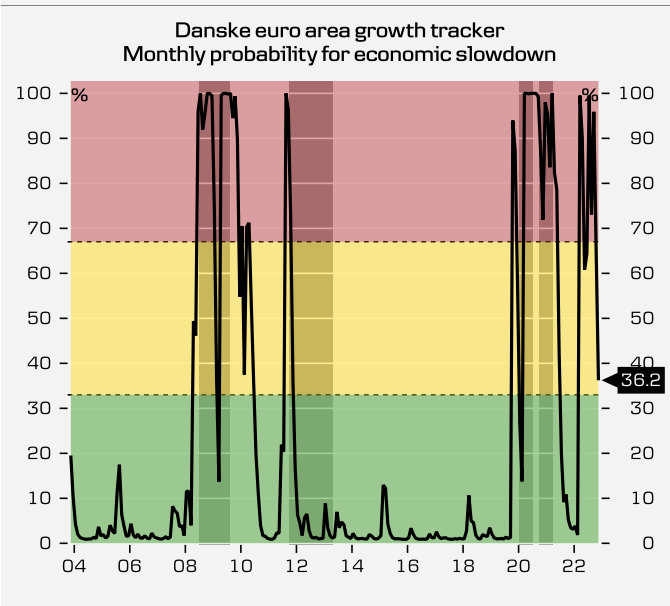
Note: Shaded area indicates historical recessions
Source: Macrobond Financial, Danske Bank

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

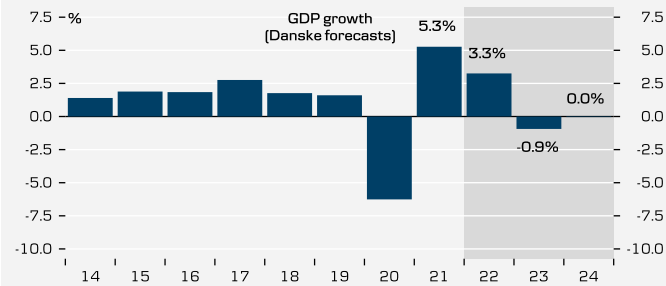
Danske growth tracker decomposition

	November 2022
Economic variables	-0.6
Profit growth	1.3
Unemployment	1.0
Credit growth	0.8
Capacity utilisation	0.3
European sentiment indicator	-0.6
Real M1 growth	-0.7
Composite PMI	-0.8
ZEW	-0.9
OECD CLI	-1.1
EuroCOIN	-1.5
PMI order-inventory balance	-2.2
Consumer confidence	-2.2
Financial variables	-0.8
Euro surprise index	0.4
Eurostoxx50	-0.8
Corporate vs. gov. bond yield	-0.9
Sentix	-1.8

Source: Danske Bank

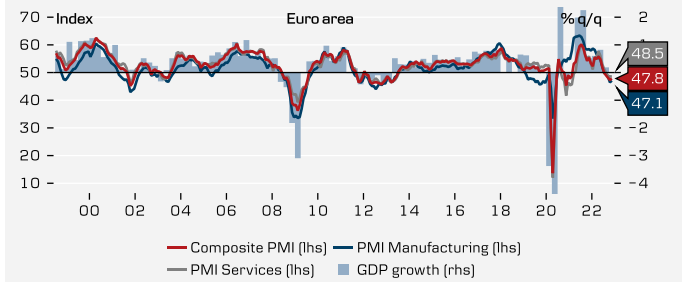
Euro area

GDP growth forecasts



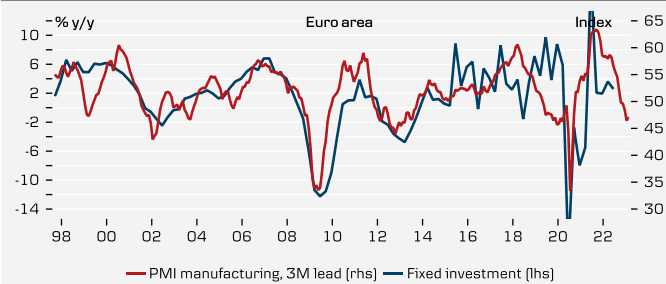
Source: Macrobond Financial, Danske Bank forecasts

PMI and GDP growth



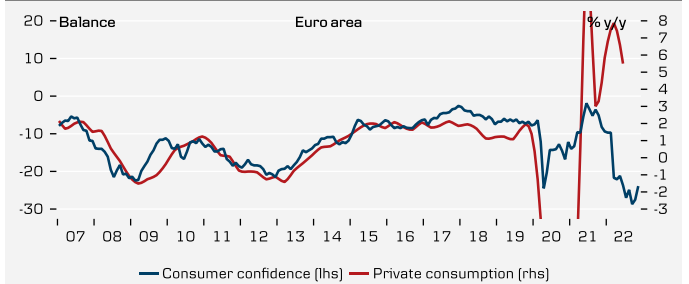
Source: Macrobond Financial, Danske Bank

Manufacturing sentiment and investments



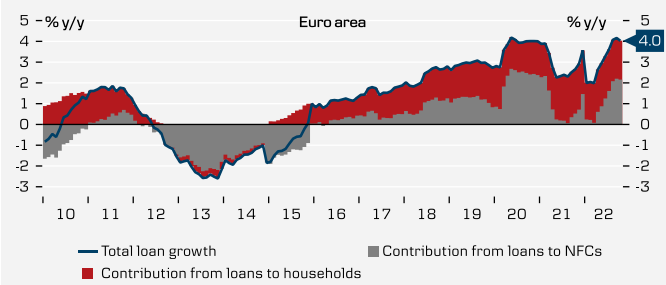
Source: Macrobond Financial, Danske Bank

Consumer confidence and private consumption



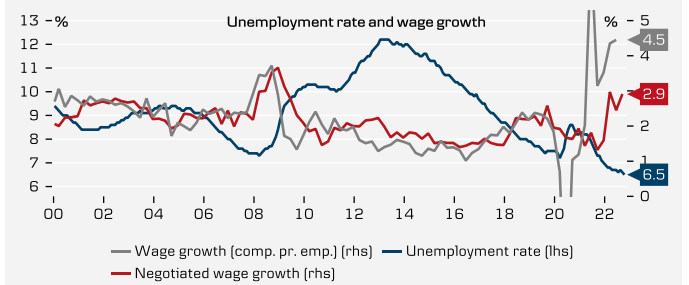
Source: Macrobond Financial, Danske Bank

Credit growth



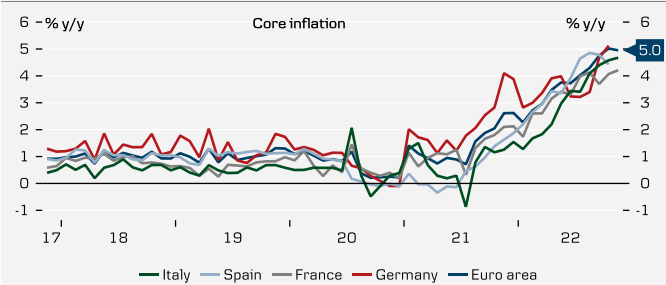
Source: Macrobond Financial, Danske Bank

Unemployment and wage growth



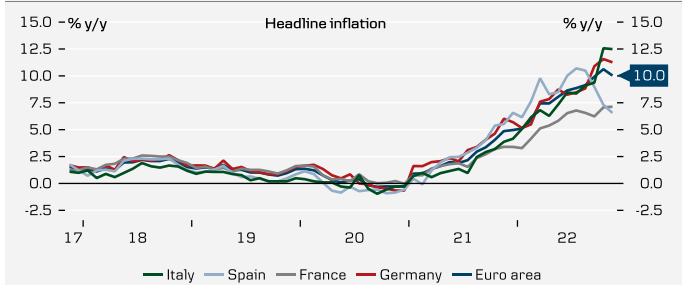
Source: Macrobond Financial, Danske Bank

Core inflation



Source: Macrobond Financial, Danske Bank

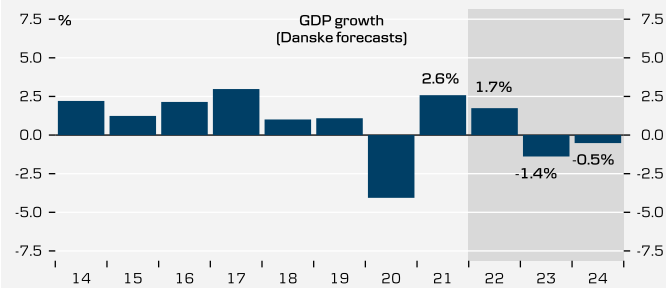
HICP inflation



Source: Macrobond Financial, Danske Bank

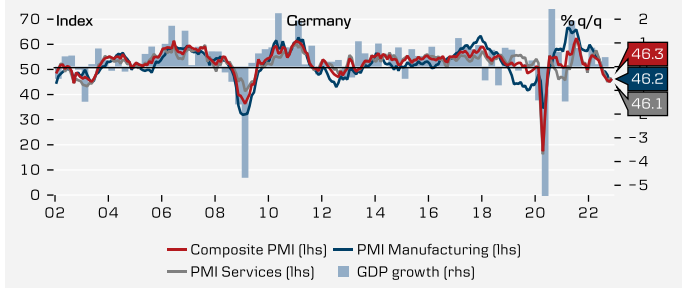
Germany

GDP growth forecasts



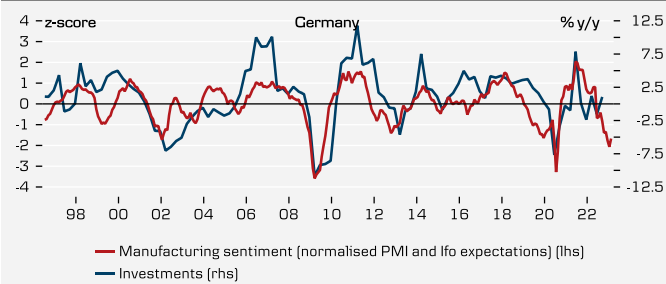
Source: Macrobond Financial, Danske Bank forecasts

PMI and GDP growth



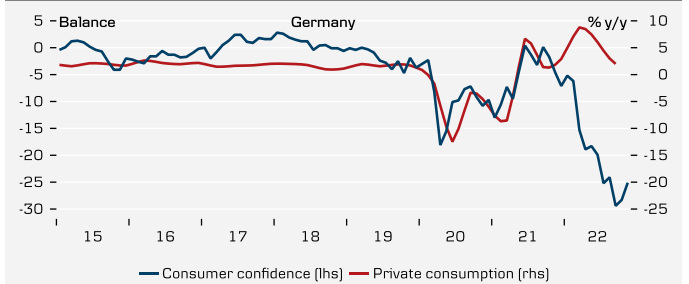
Source: Macrobond Financial, Danske Bank

Manufacturing sentiment and investments



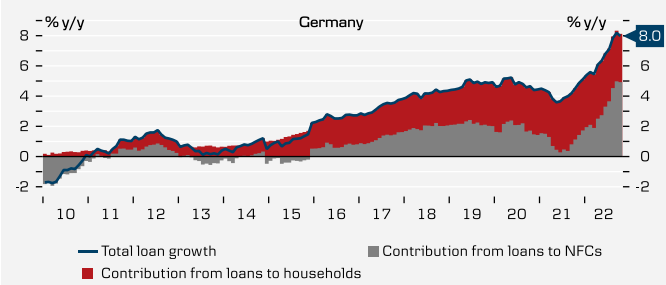
Source: Macrobond Financial, Danske Bank

Consumer confidence and private consumption



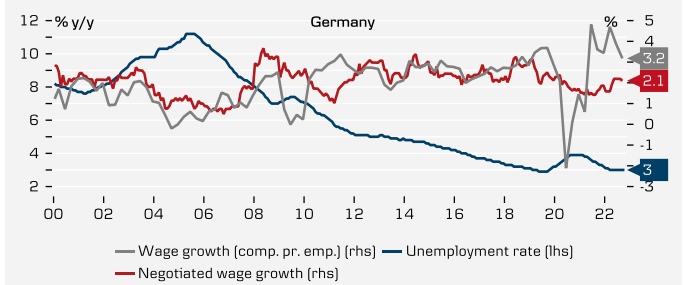
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Credit growth



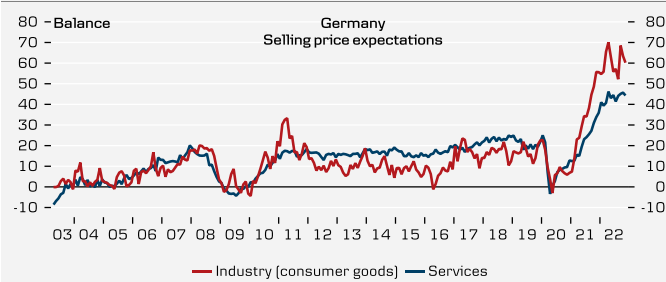
Source: Macrobond Financial, Danske Bank

Unemployment and wage growth



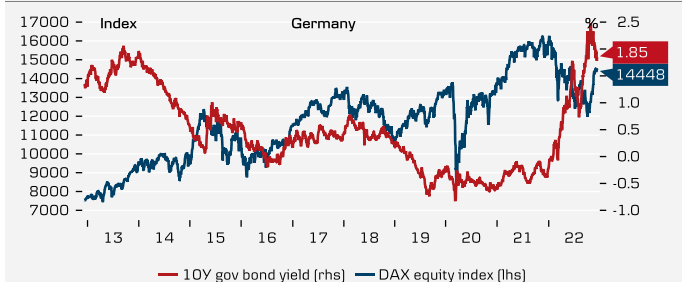
Source: Macrobond Financial, Danske Bank

Price expectations



Source: EU Commission, Macrobond Financial, Danske Bank

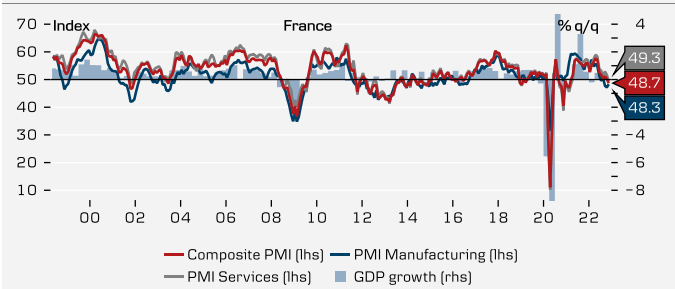
Financial markets



Source: Macrobond Financial, Danske Bank

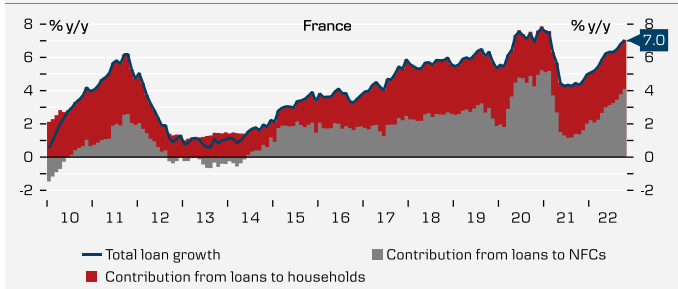
France

PMI and GDP growth



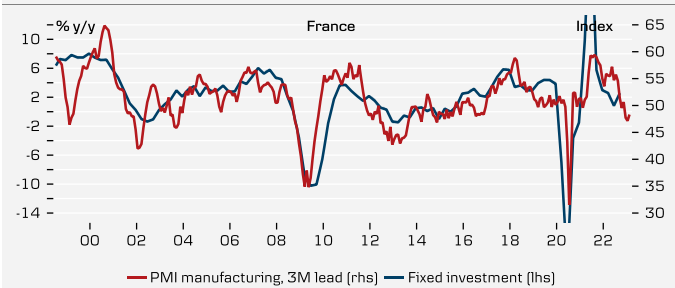
Source: Macrobond Financial, Danske Bank

Credit growth



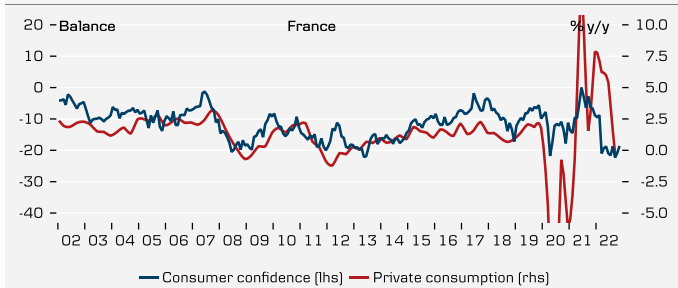
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Manufacturing sentiment and investments



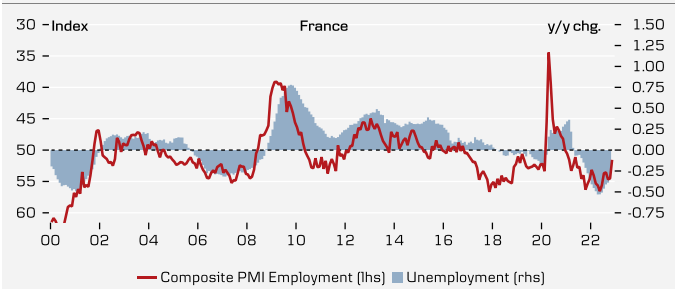
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Consumer confidence and private consumption



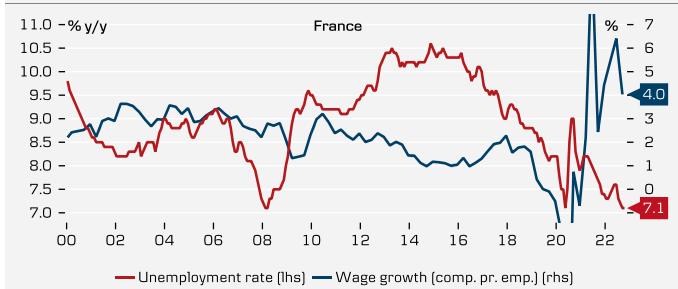
Source: Macrobond Financial, Danske Bank

Unemployment and PMI



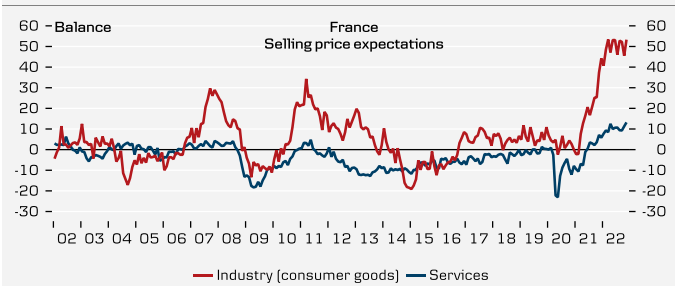
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Unemployment and wage growth



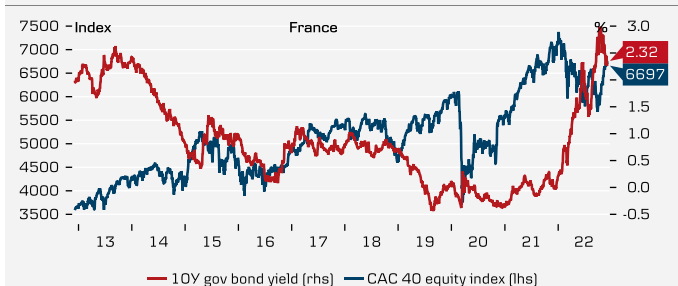
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Price expectations



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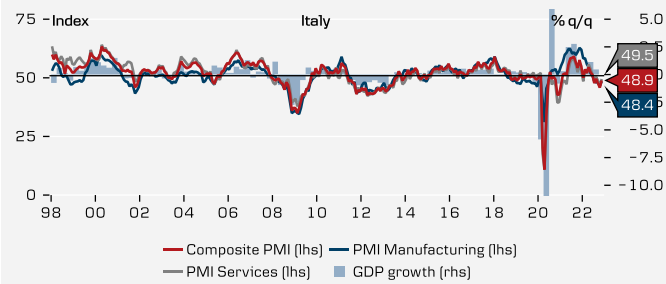
Financial markets



Source: Macrobond Financial, Danske Bank

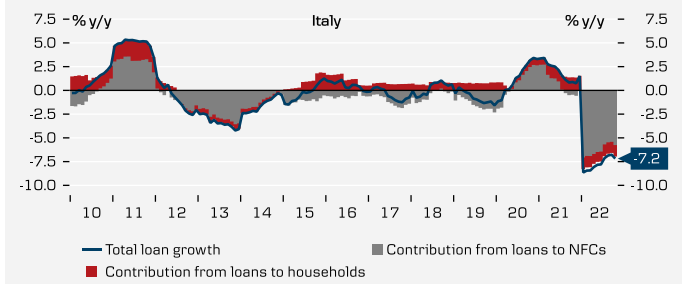
Italy

PMI and GDP growth



Source: Macrobond Financial, Danske Bank

Credit growth



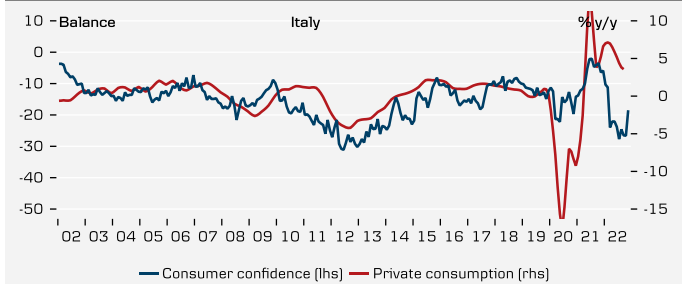
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Manufacturing sentiment and investments



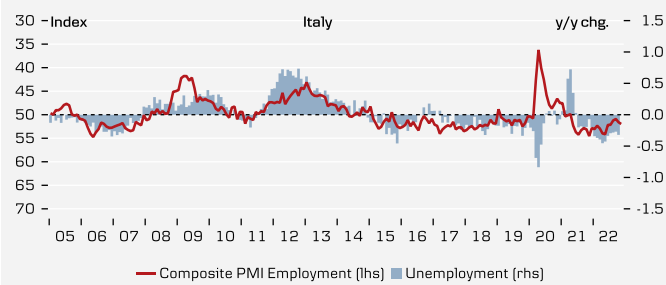
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Consumer confidence and private consumption



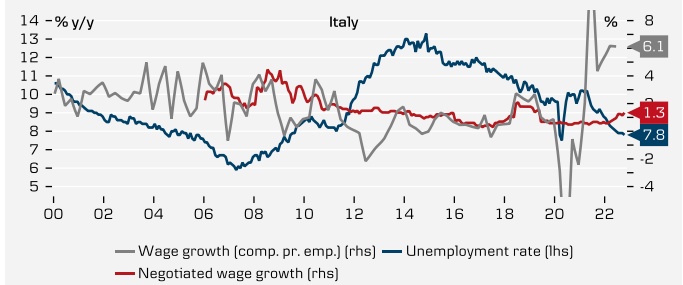
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Unemployment and PMI



Source: Macrobond Financial, Danske Bank

Unemployment and wage growth



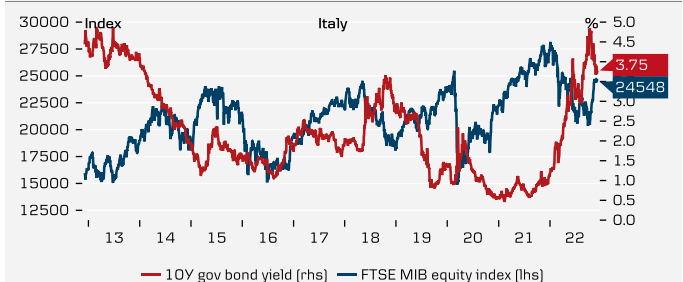
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Price expectations



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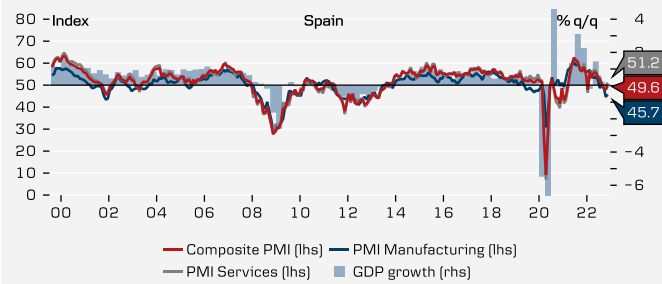
Financial markets



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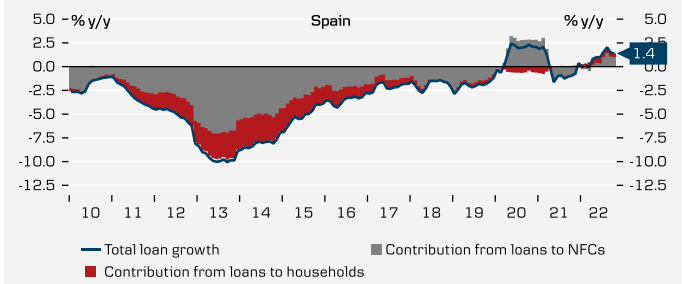
Spain

PMI and GDP growth



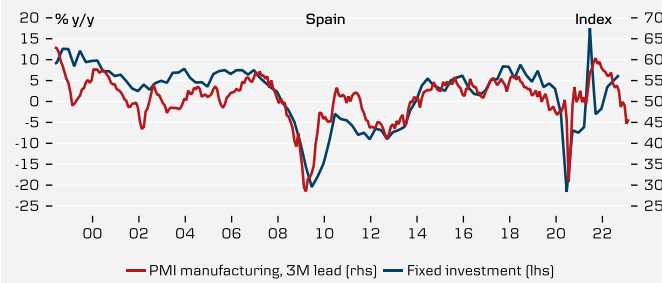
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Credit growth



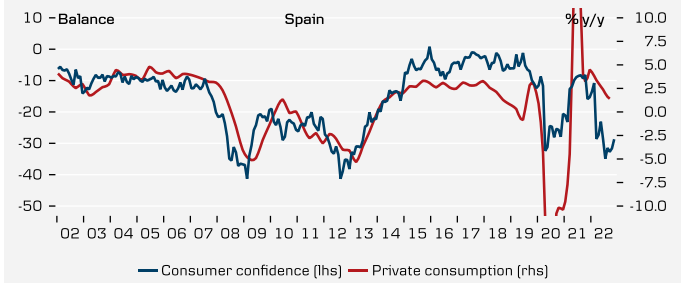
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Manufacturing sentiment and investments



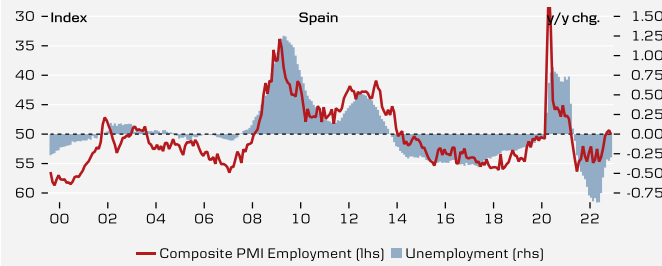
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Consumer confidence and private consumption



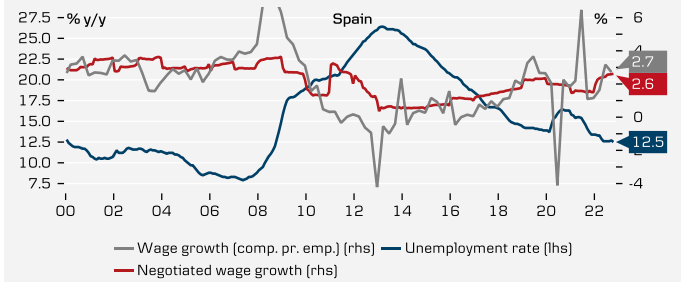
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Unemployment and PMI



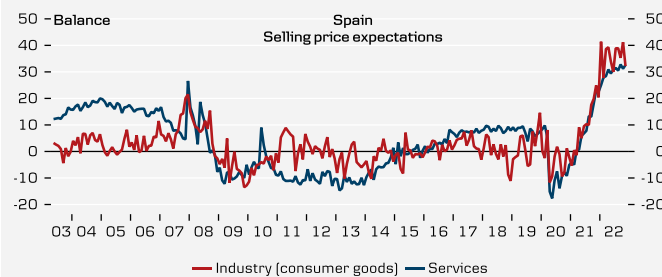
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Unemployment and wage growth



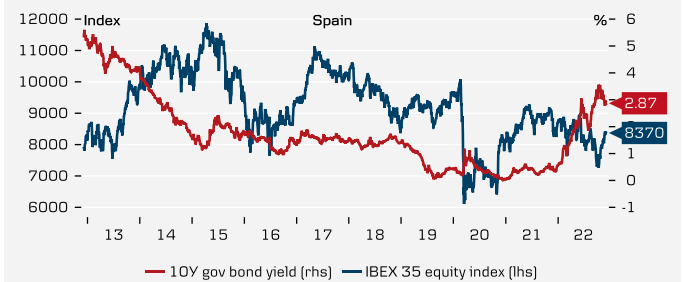
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Price expectations



Source: EU Commission, Macrobond Financial, Danske Bank

Financial markets



Source: Macrobond Financial, Danske Bank

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