

EURO AREA: THE OUTLOOK BEYOND RESILIENCE

Europe is resilient, but needs more dynamic growth

Pilar Castrillo, Head of Economic and Market Analysis & Gergely Hudecz, Principal Economist

18 April 2024, Washington DC



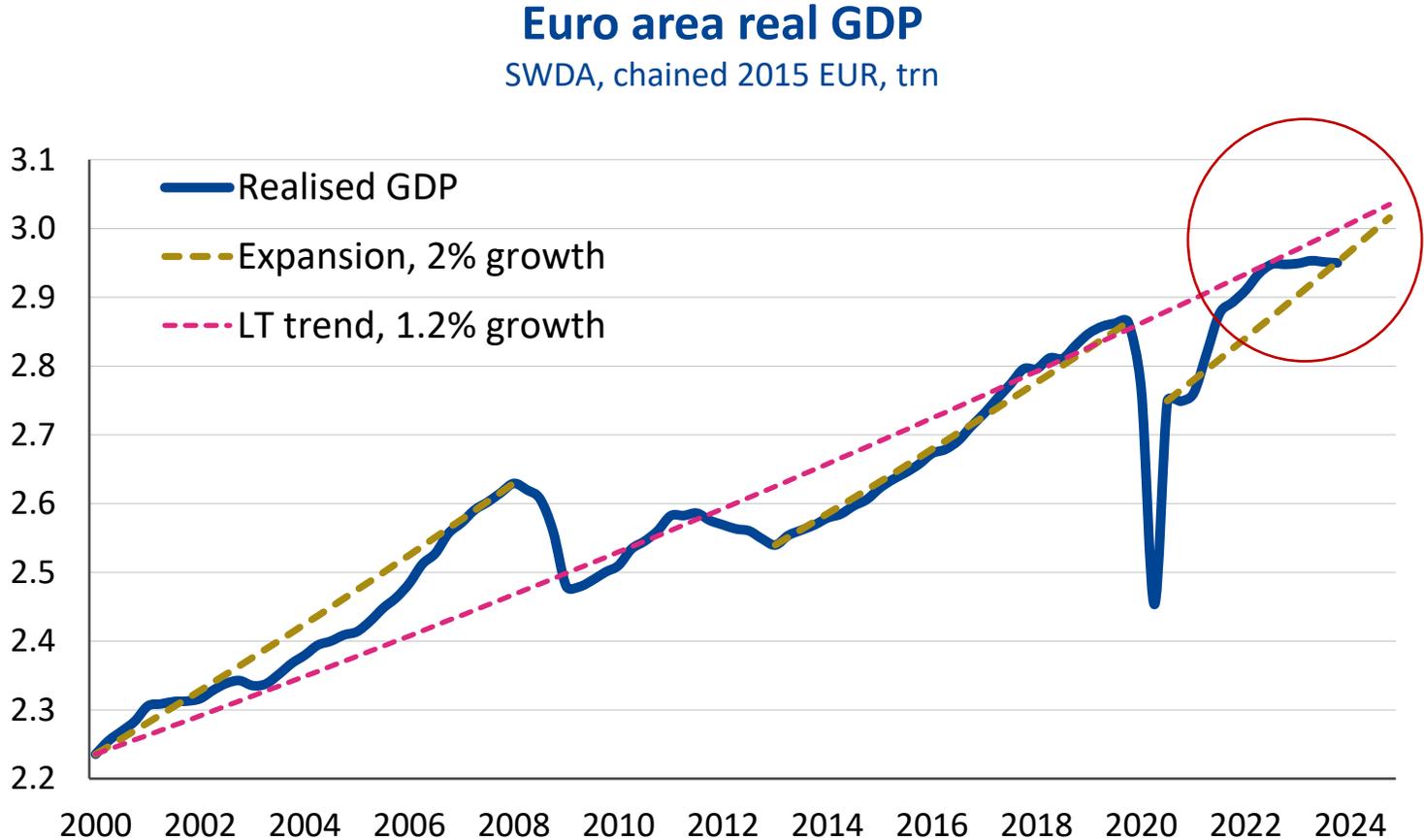
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- Slow recovery... cyclical or structural weakness?
- Where does this leave the policy mix?
- Implications for sovereign debt markets

EURO AREA ECONOMIC OUTLOOK



THE OUTLOOK FOR THE REBOUND: A 1% OR 2% ECONOMY?

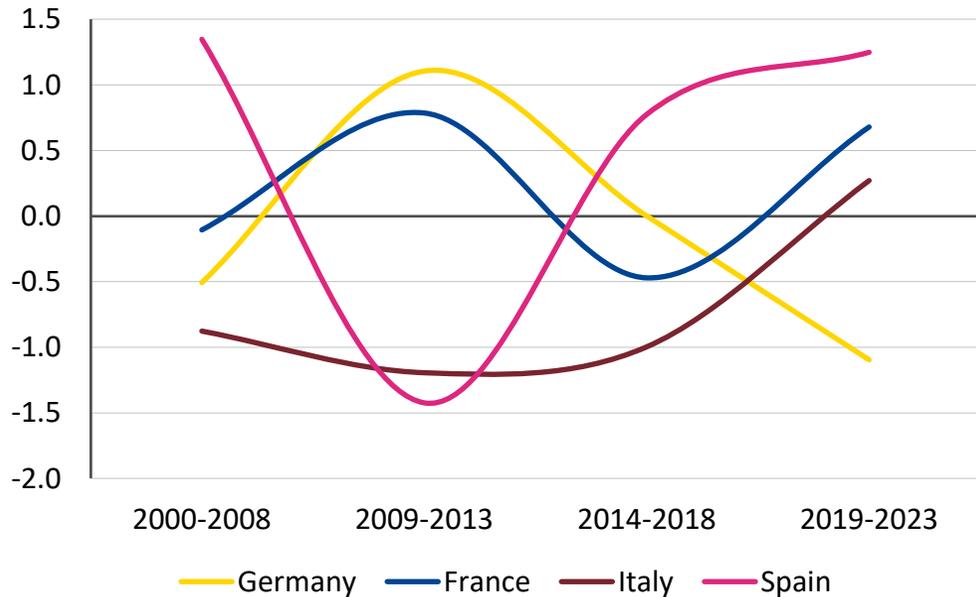


Source: ESM, Eurostat, European Commission 2024 Winter forecast

CHANGING GEOMETRY

Germany lagging...

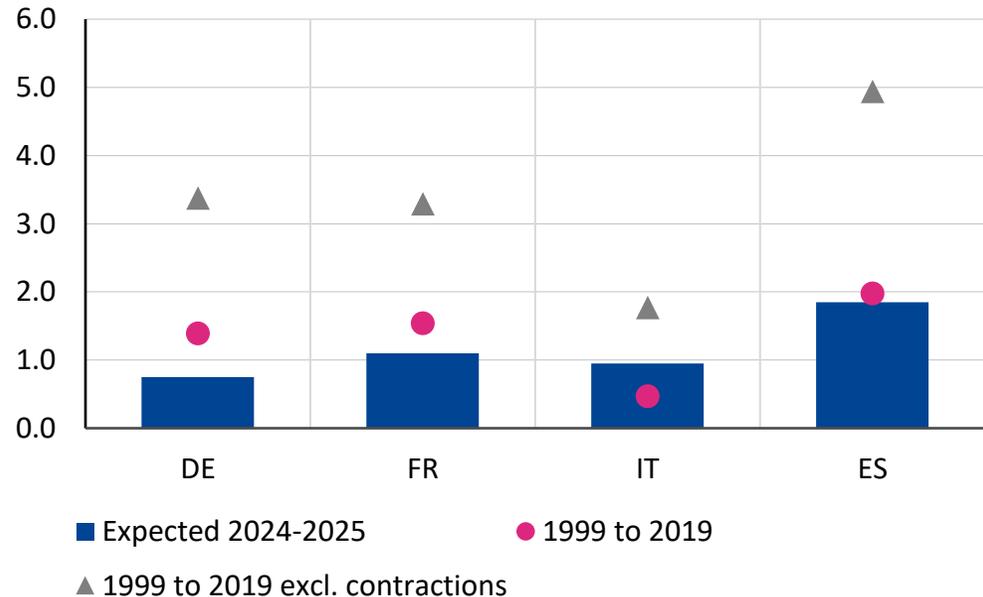
Real GDP growth, difference compared to average EA growth rate



Source: ESM, Eurostat

...and major economies grow below trend

Annual GDP growth, average of the periods, %

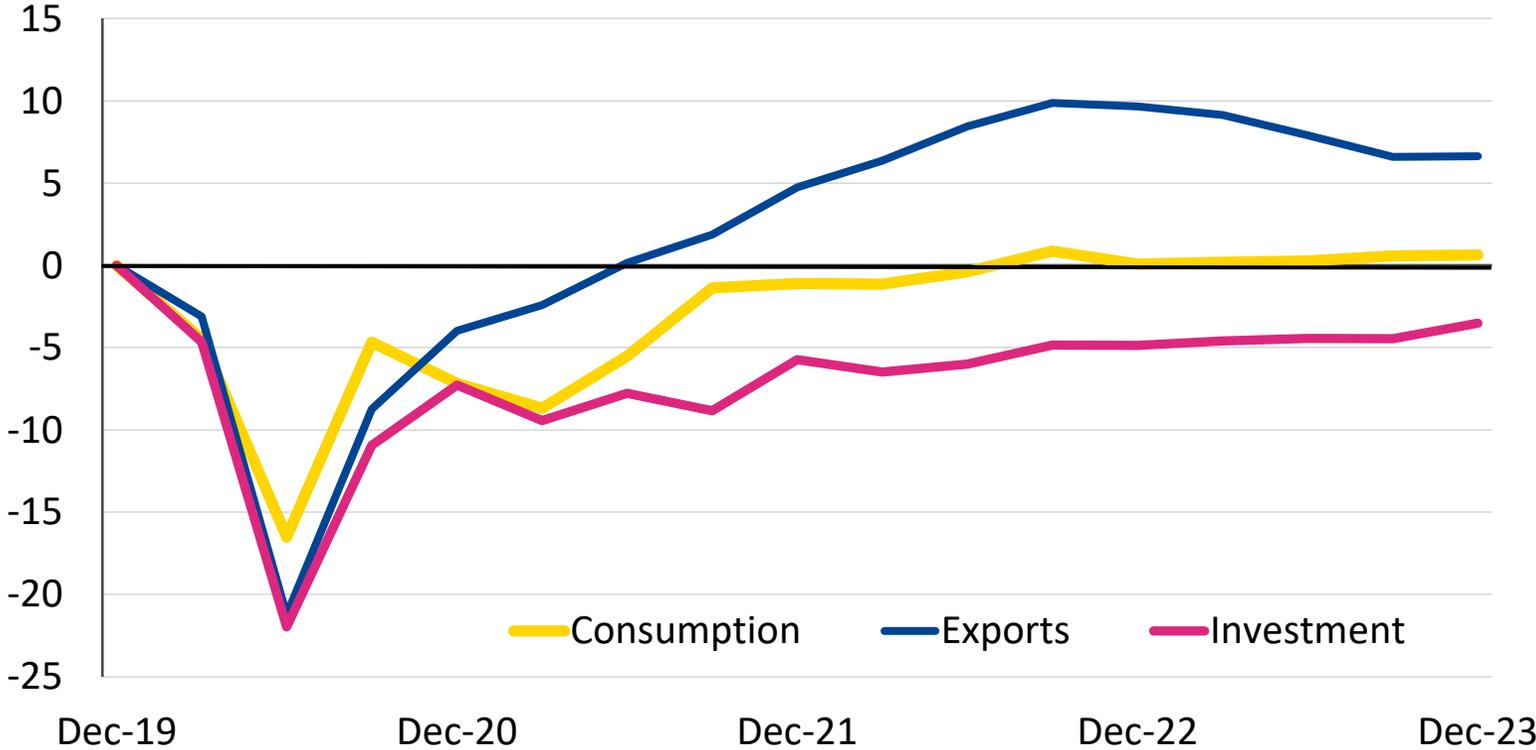


Source: ESM, Eurostat, European Commission Winter Forecasts 2024

WHEN GLOBAL GROWTH SNEEZES...

Drivers of the rebound and the slowdown

Euro area GDP components compared to Q4-2019 in %

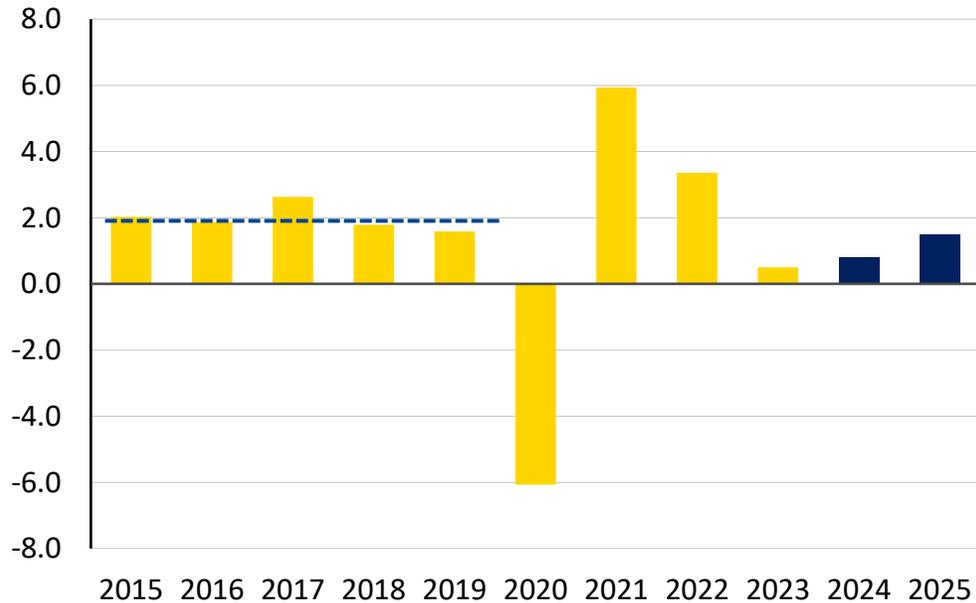


Source: ESM, Eurostat

BASELINE SCENARIO 2024-25 IN PERSPECTIVE

Euro area annual GDP growth 2015-25

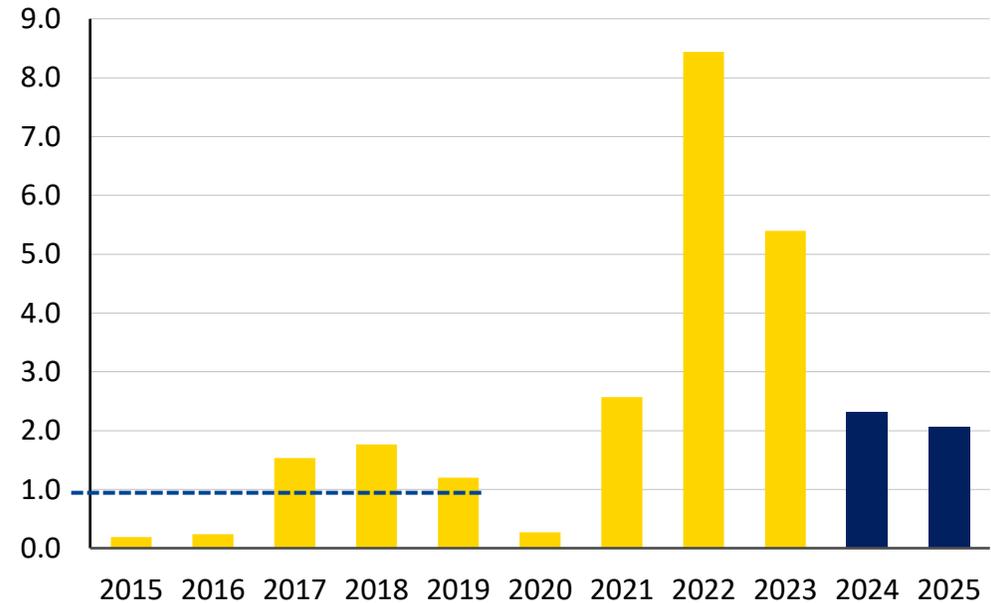
% annual growth rates



Source: ESM and Eurostat. 2024 and 2025 reflect the averages of ECB (Mar 24), EC (Feb 24) and Consensus Forecasts (Apr 24)

Euro area inflation 2015-25

% annual growth rates

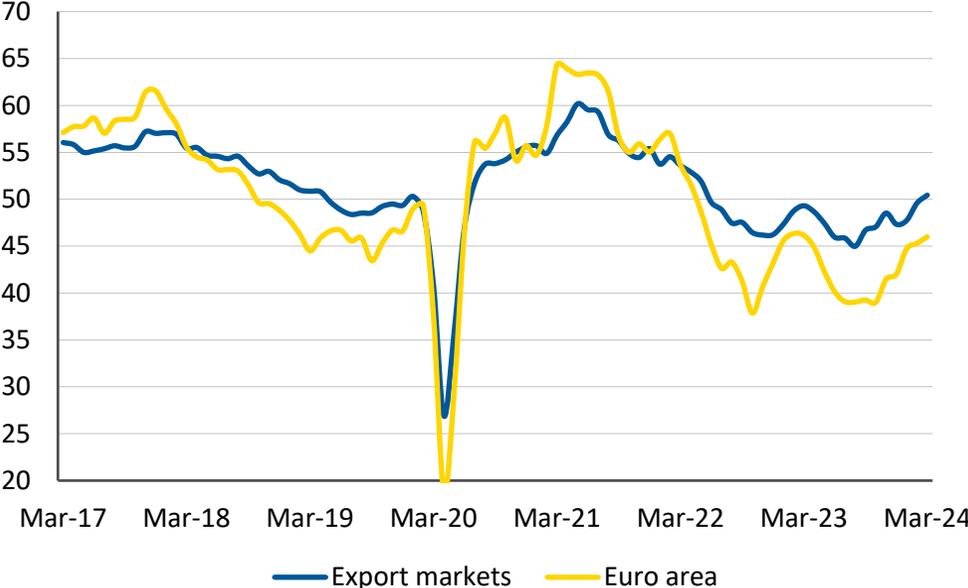


Source: ESM and Eurostat. 2024 and 2025 figures reflect the averages of ECB (Mar 24), EC (Feb 24) and Consensus Forecasts (Apr 24)

SIGNS OF CYCLICAL RECOVERY IN EARLY 2024

Manufacturing new orders rebound

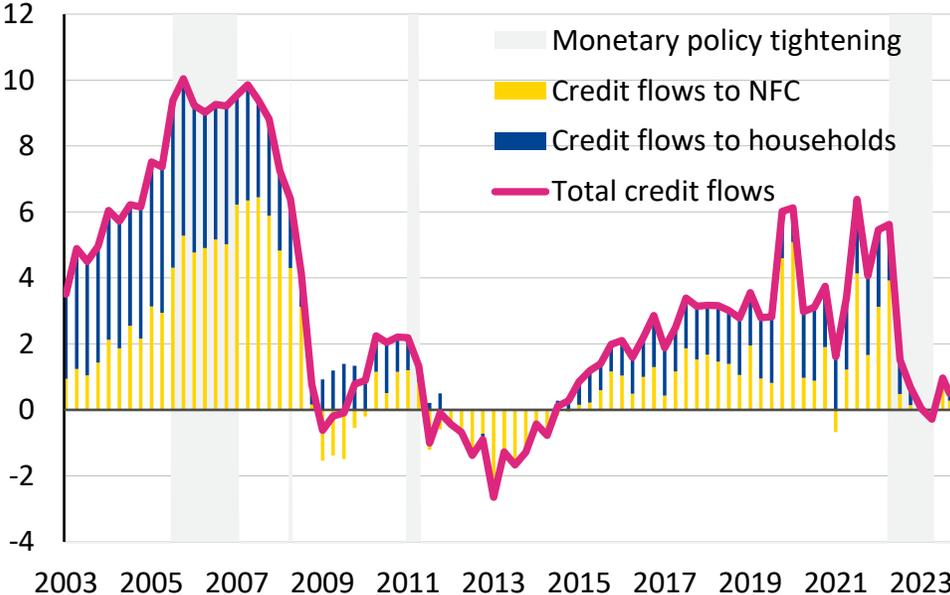
Trade-weighted and euro area manufacturing PMIs



Source: ESM based on Copyright © (2023), S&P GlobalTM. All rights reserved.

Credit flows bottoming out?

Credit to households and firms, quarterly flows, % of GDP

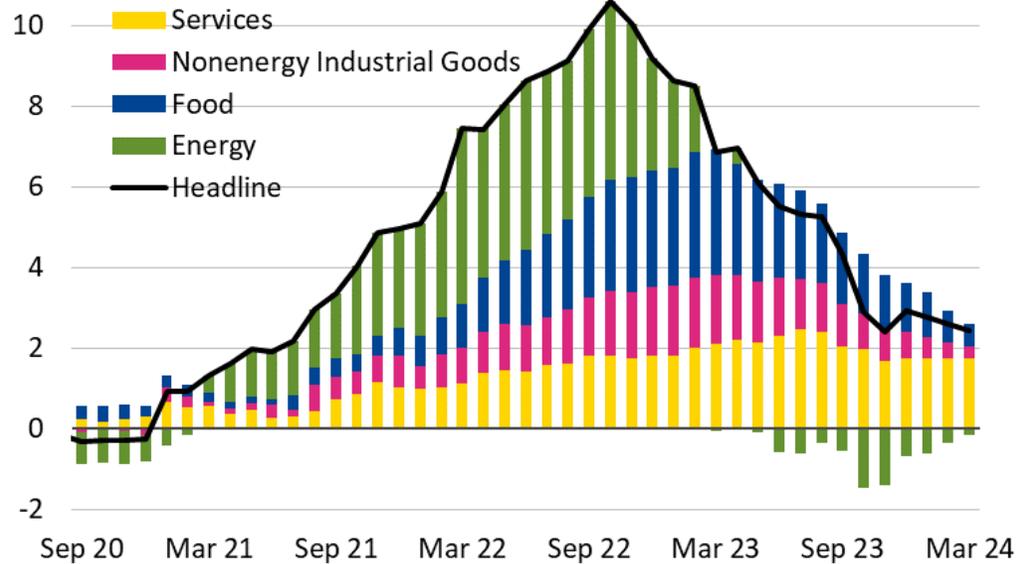


Source: ESM based on ECB and Eurostat.

REBOUND OF HOUSEHOLDS' REAL INCOME SUPPORTS GROWTH

Euro area inflation trending down

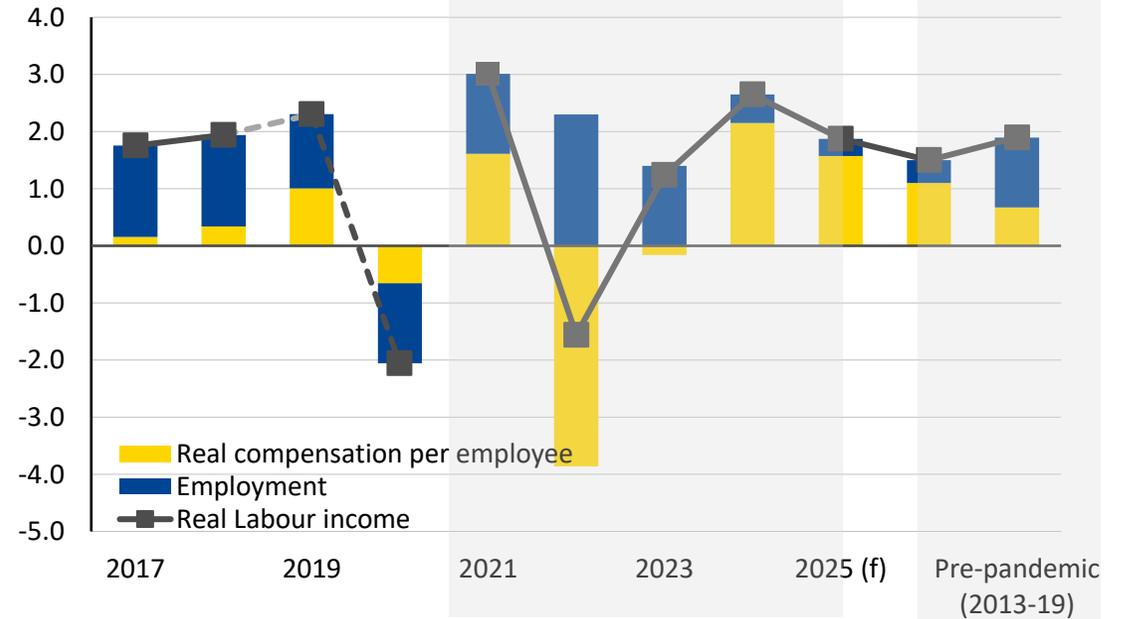
Contributions to year-on-year change, pps



Source: Eurostat

Euro area real labour income recovery

Contributions to year-on-year change, pps

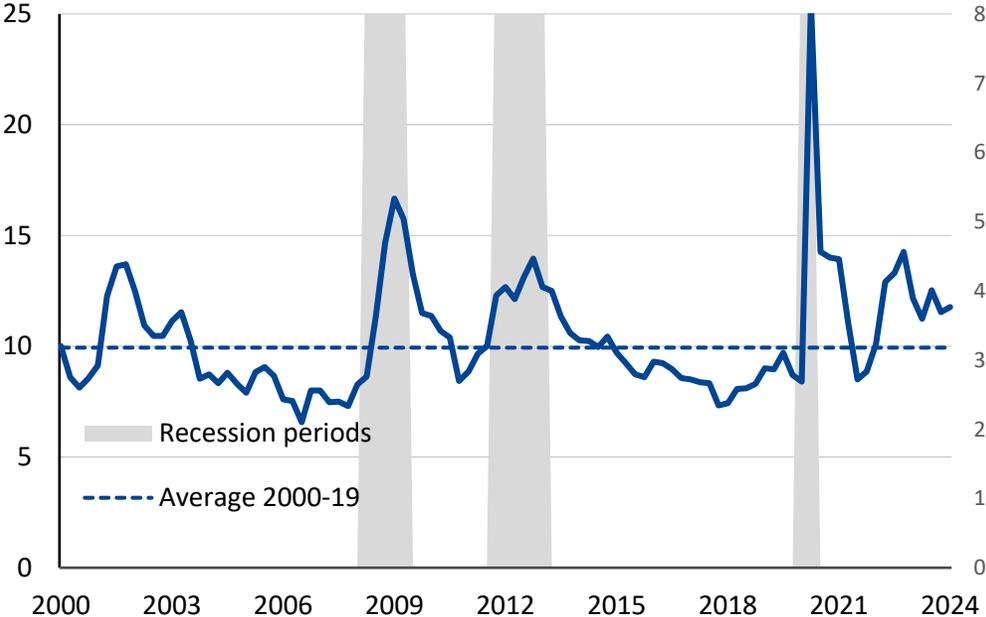


Source: ESM, based on Eurostat and ECB Macroeconomic projections March 2024.

SUBDUED PRODUCTIVITY: CYCLICAL OR STRUCTURAL?

Labour hoarding indicator

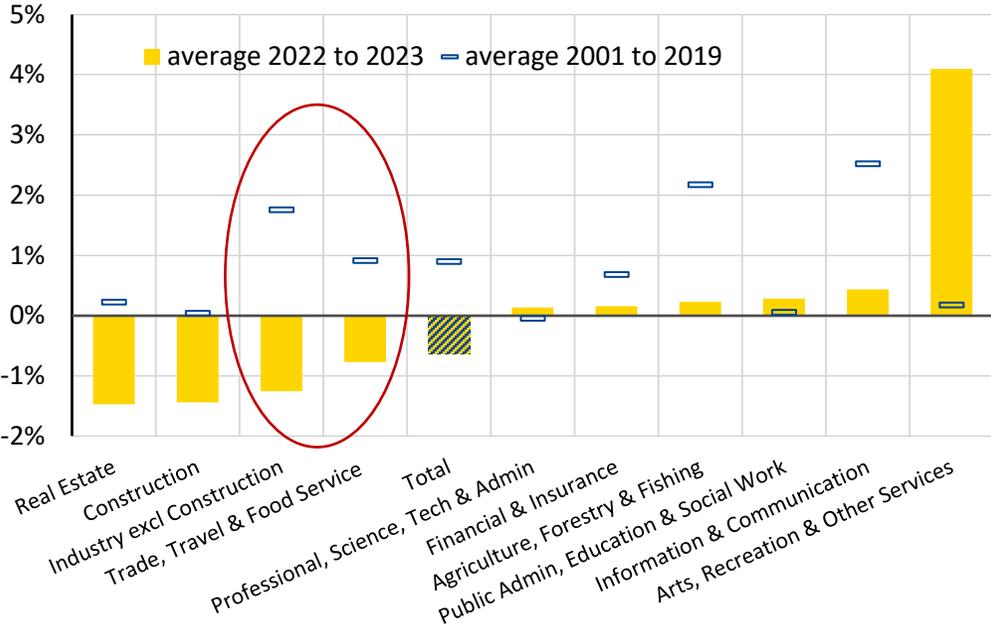
% of firms that hoard labour, 3-month average



Source: ECB Business and Consumer Surveys, EABCN. Note: The indicator combines answers of managers to two survey questions, and points to labour hoarding when they expect output to decrease and employment to be unchanged or increase in the next three months.

Labour productivity across sectors

Annual growth rates, average of the periods, %

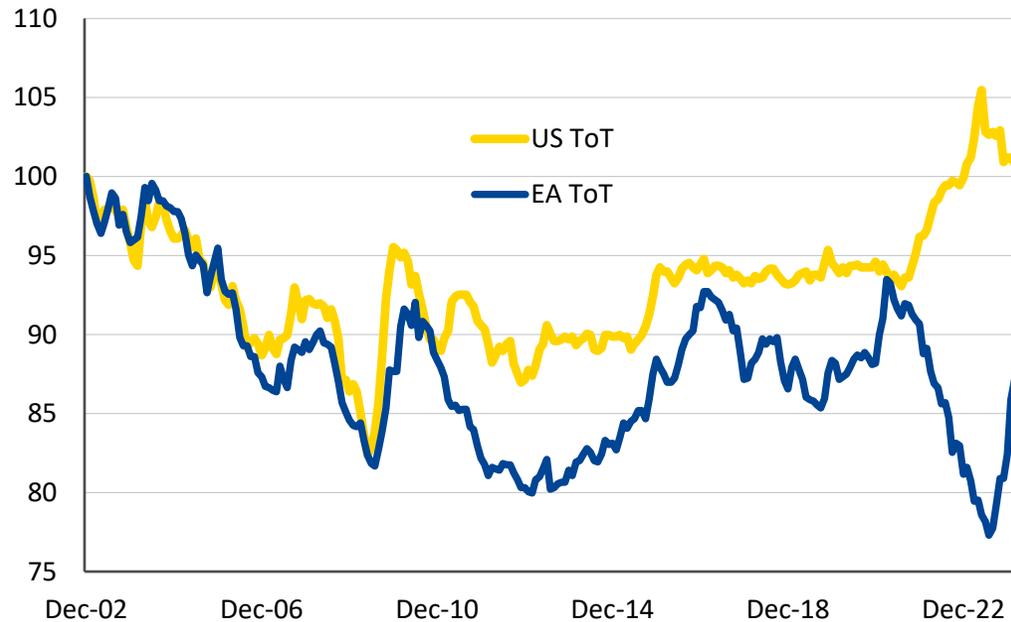


Source: Eurostat, European Central Bank and ESM calculations. Note: Labour productivity is measured as per hours.

HIGH AND VOLATILE ENERGY PRICES CHALLENGE COMPETITIVENESS

Differentiated impact of terms of trade

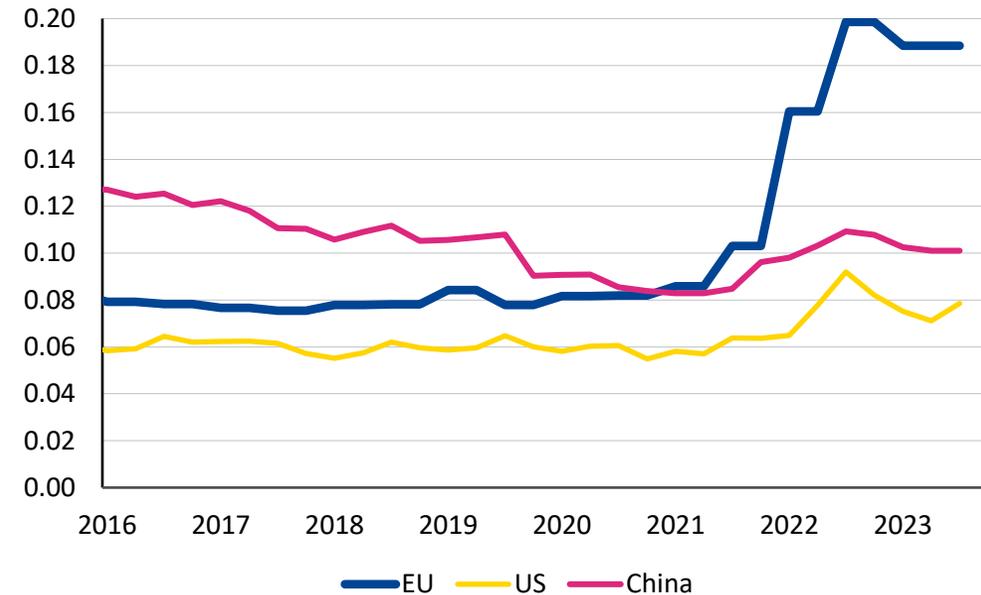
Index, s.a., Jan 2002=100



Source: Eurostat, Bureau of Labour Statistics

Electricity price for industrial consumers

EUR KW/h

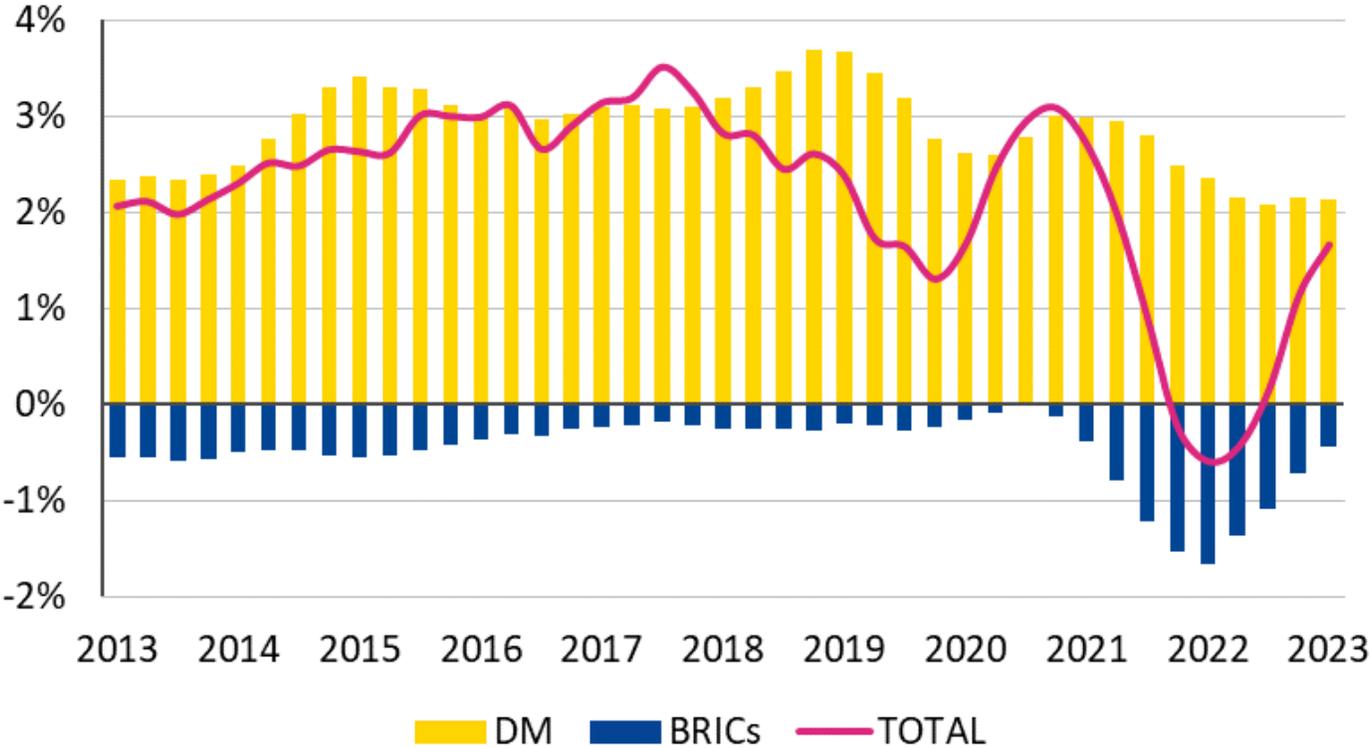


Sources: ESM based on Eurostat, EIA, DESNZ, IMF.

ALONG WITH A MORE FRAGMENTED GLOBAL ENVIRONMENT

Euro area current account balance

Split by developed and emerging markets, 4q-roll, % of GDP



Source: ESM based on Eurostat, ECB

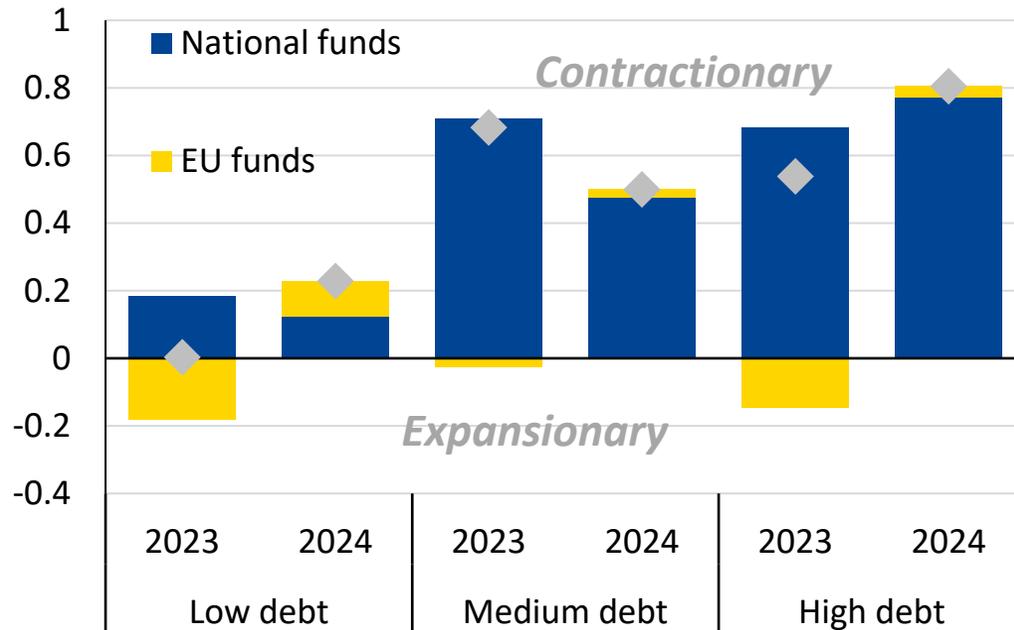
THE POLICY MIX



FISCAL CHALLENGES: BUILD UP BUFFERS, INVEST & REFORM

Fiscal stance in the euro area

% of GDP

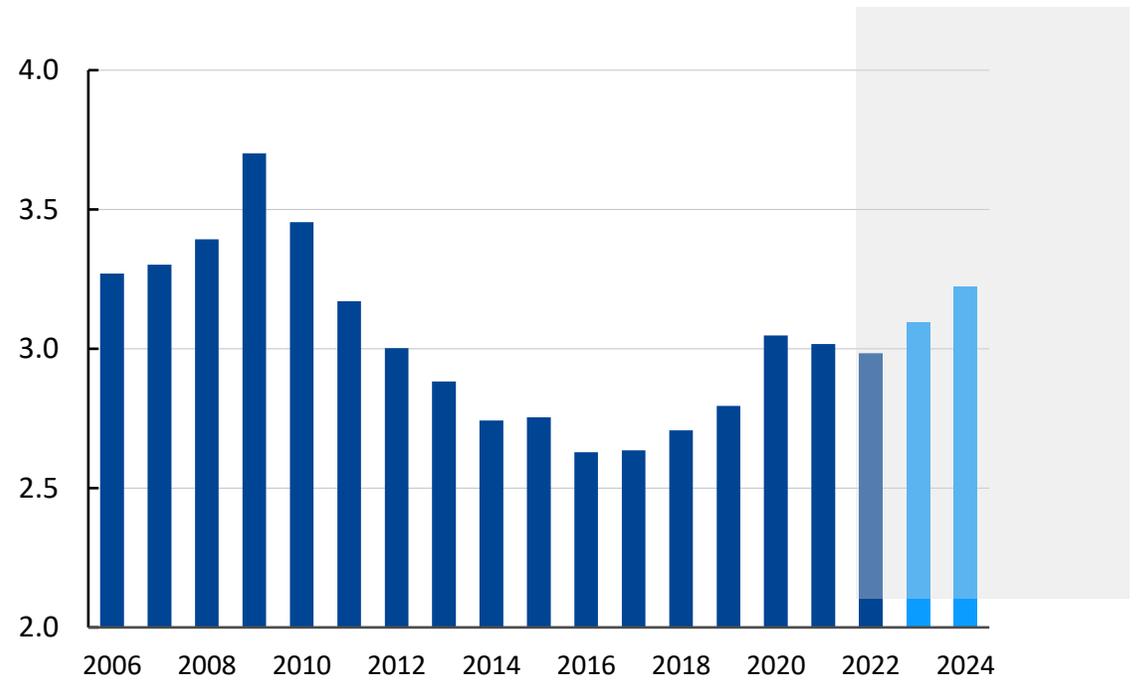


Source: ESM based on European Commission Autumn Forecasts 2023 .

Note: Fiscal stance based on the change in net primary expenditure relative to the medium-term average potential nominal GDP growth rate. Groups: GDP- weighted average based on public debt levels : low (below 60% GDP), medium (between 60% and 90%) and high (above 90% GDP),

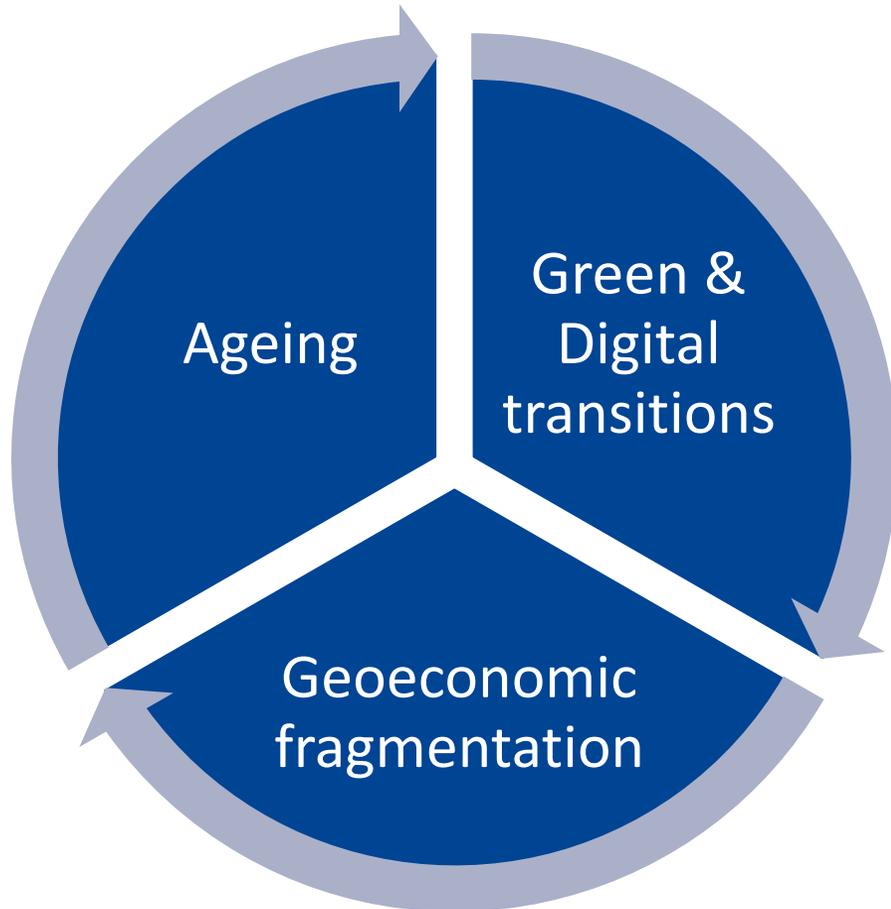
Public investment

% of GDP



Source: European Commission Autumn Forecasts 2023.

EU MEDIUM-TERM AGENDA: RESILIENCE AND COMPETITIVENESS VS GLOBAL CHALLENGES



Economic Governance Review implementation



Strategic use of financial resources



Open Strategic Autonomy

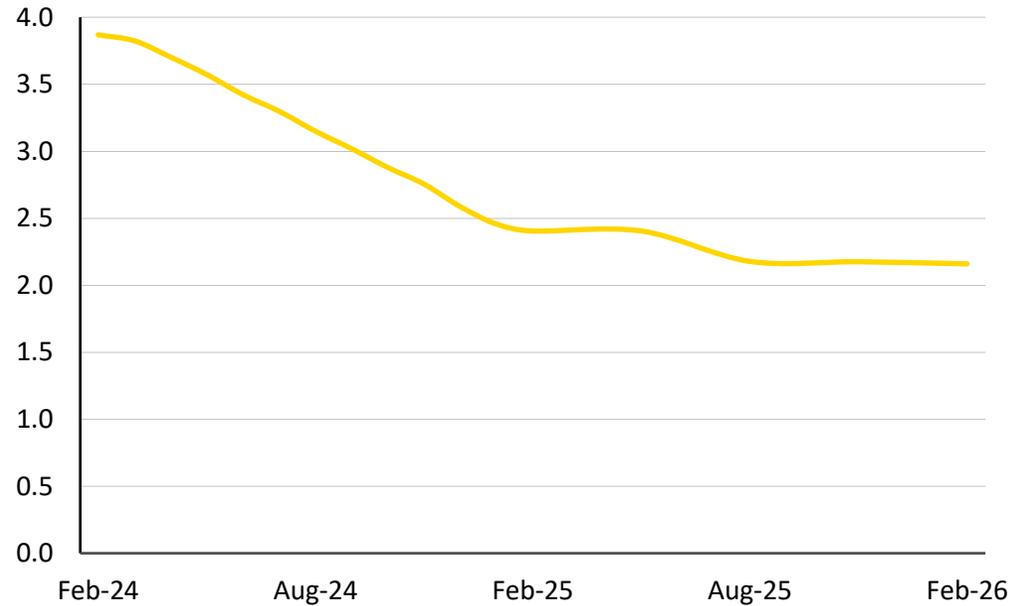


Deepen Single Market

MONETARY POLICY: HOW FAST AND HOW LOW?

Market-implied policy rate path

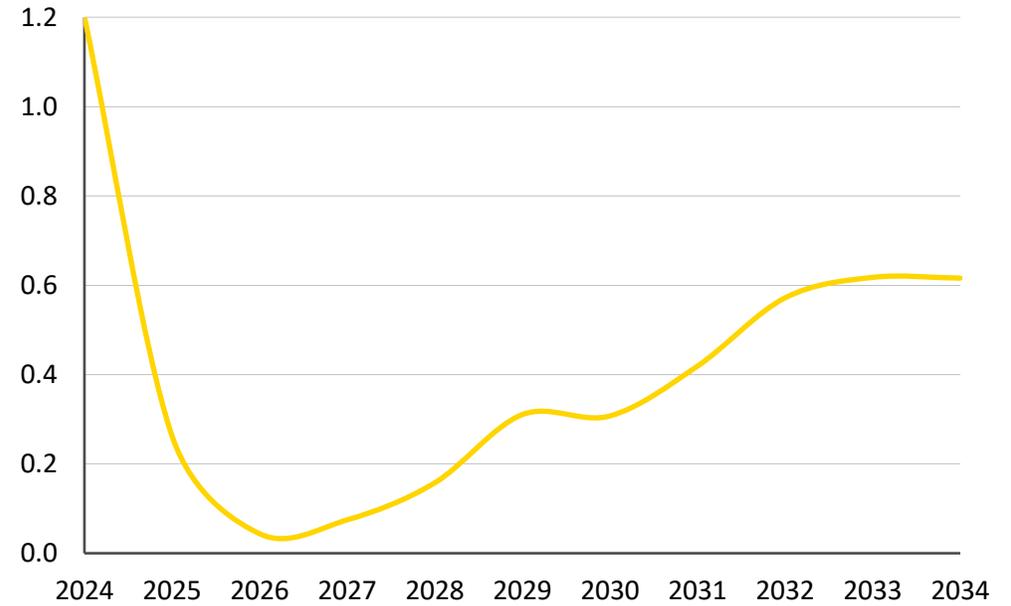
As of 9 February



Source: ESM based on Bloomberg data

Market-implied real rate path

As of 9 February

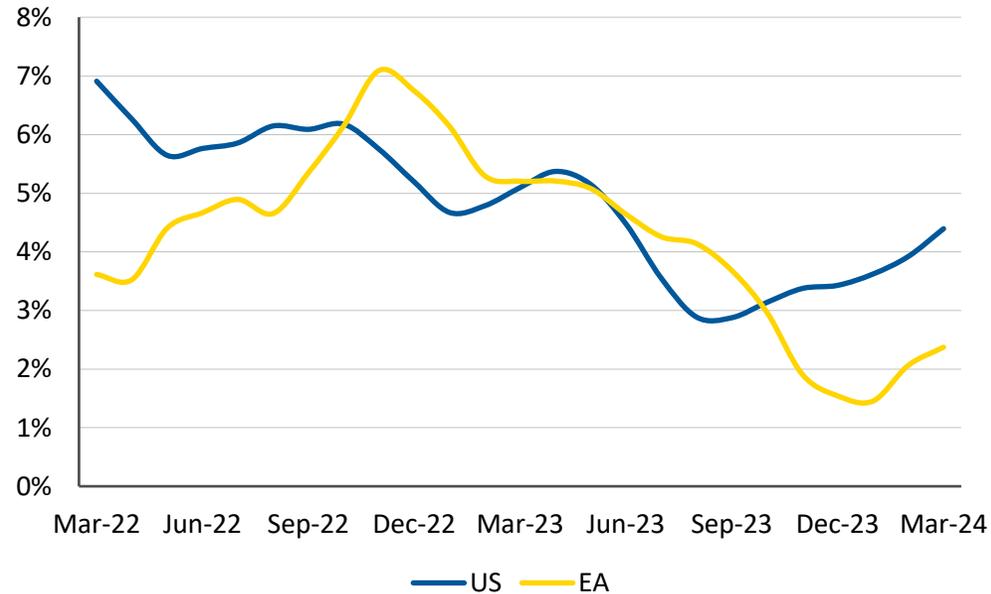


Source: ESM based on Bloomberg data

INFLATION DYNAMICS DIVERGE, CAN RATES DECOUPLE FROM US?

Inflation dynamics are different...

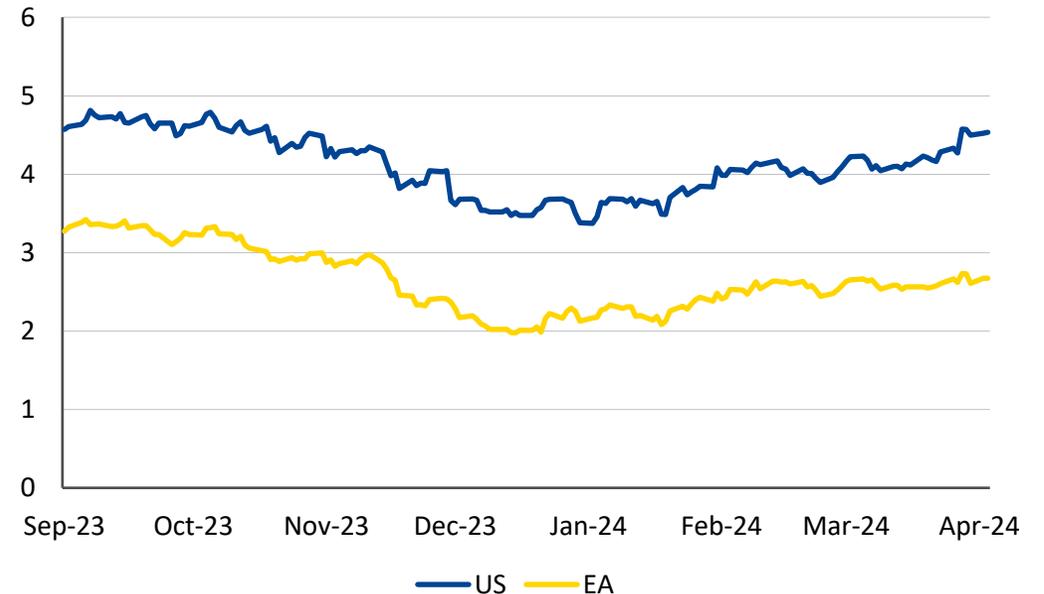
3-month run-rate of core inflation annualised



Source: ESM based on data from DLX/Haver Analytics

...but rates moved together until recently

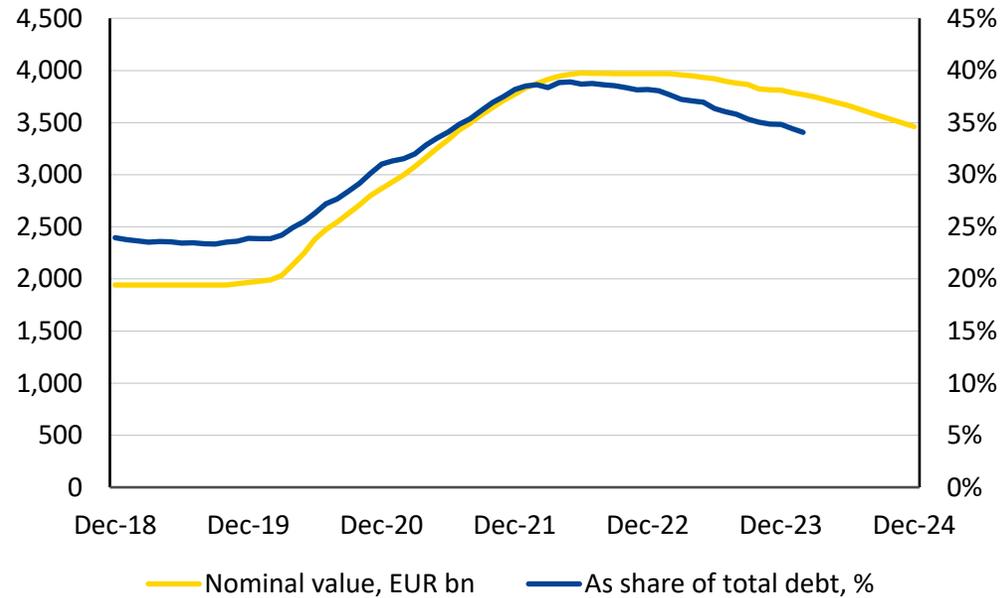
3-month rate expected 1-year ahead, %



Source: ESM based on Bloomberg data

IN THE MEANTIME, QT IS PROGRESSING...

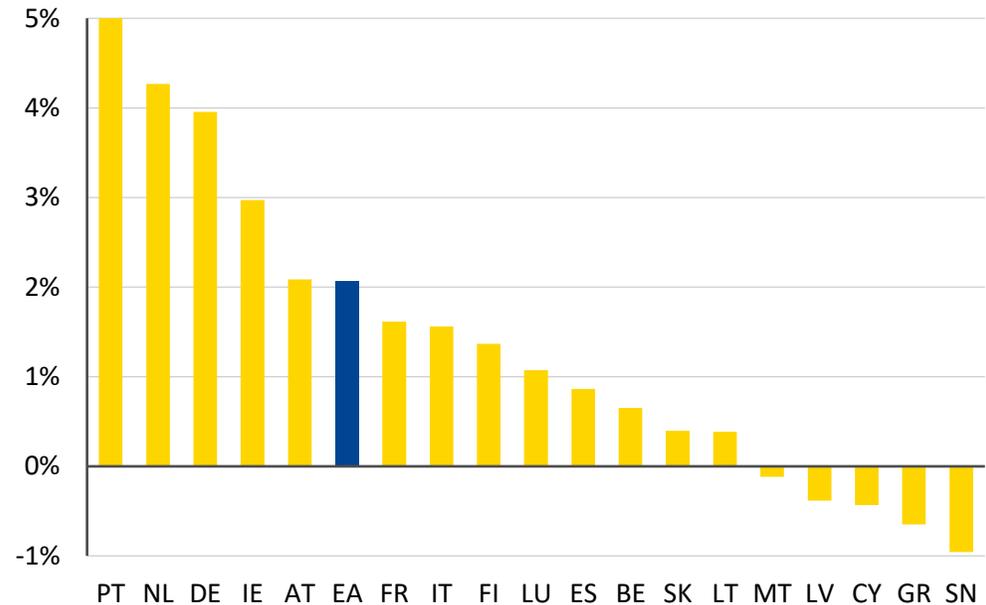
Eurosystem government bond holdings



Source: ESM based on ECB data

ECB net sales since June 2022

As % of current stock of marketable debt



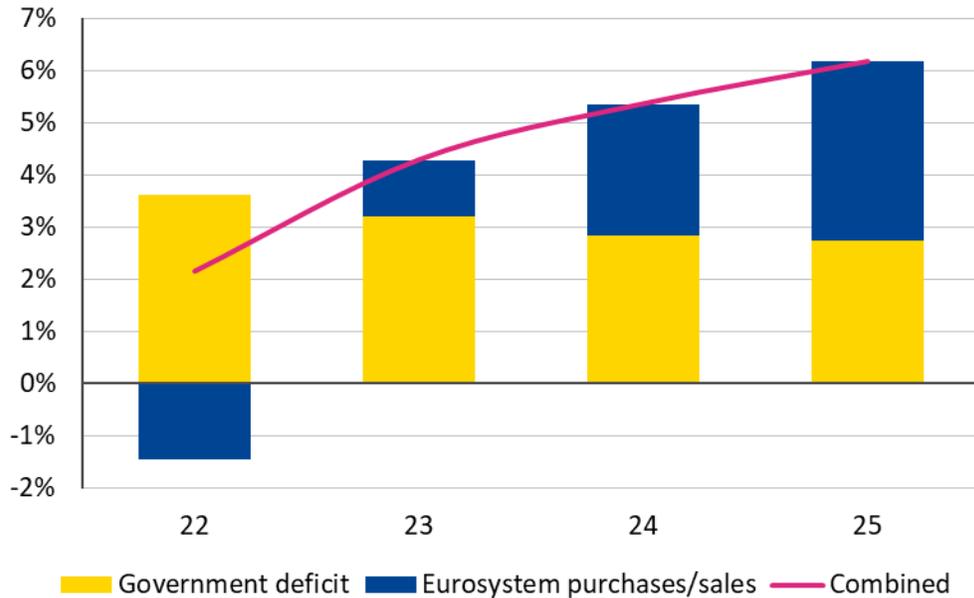
Source: ESM based on ECB data

IMPLICATIONS FOR SOVEREIGN BOND MARKETS



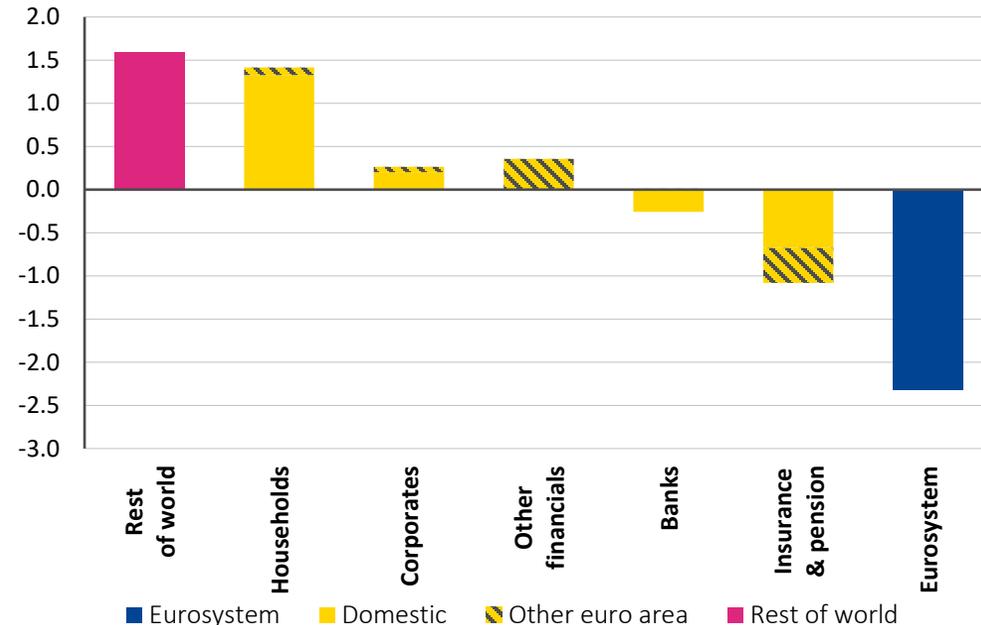
BOND DEMAND: WHO PICKS UP THE SLACK?

Euro area sovereign market financing needs % of GDP



Note: Estimates of Eurosystem amortizations are based on WAM of holdings as of November 2023 for PEPP, and December 2023 for PSPP. Source: European Commission 2023 Autumn forecast and ECB guidance.

Change in share of govt. debt holdings (Q1-Q3/2023, in percentage points)

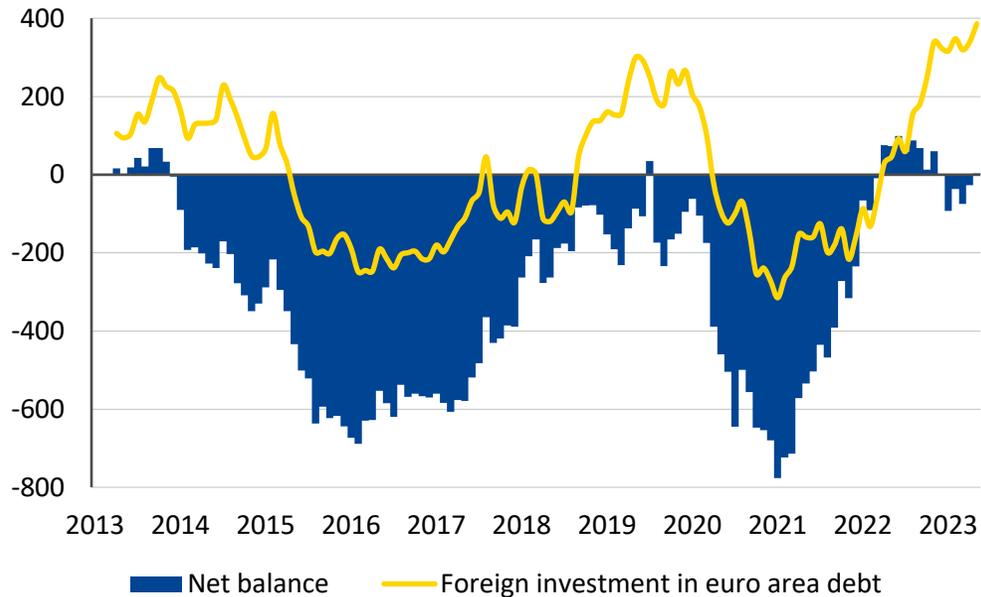


Note: The chart reports the change in the share of each sector's holdings (at market valuation) of general government debt securities issued by Germany, France, Italy, Spain, Belgium, Netherlands, Austria, Portugal, Greece, and Finland (combined) between end-2022 and 2023/Q3. Source: ESM calculations based on European Central Bank and Eurostat data.

BOND DEMAND: WHO PICKS UP THE SLACK?

Foreign investors return to euro area debt

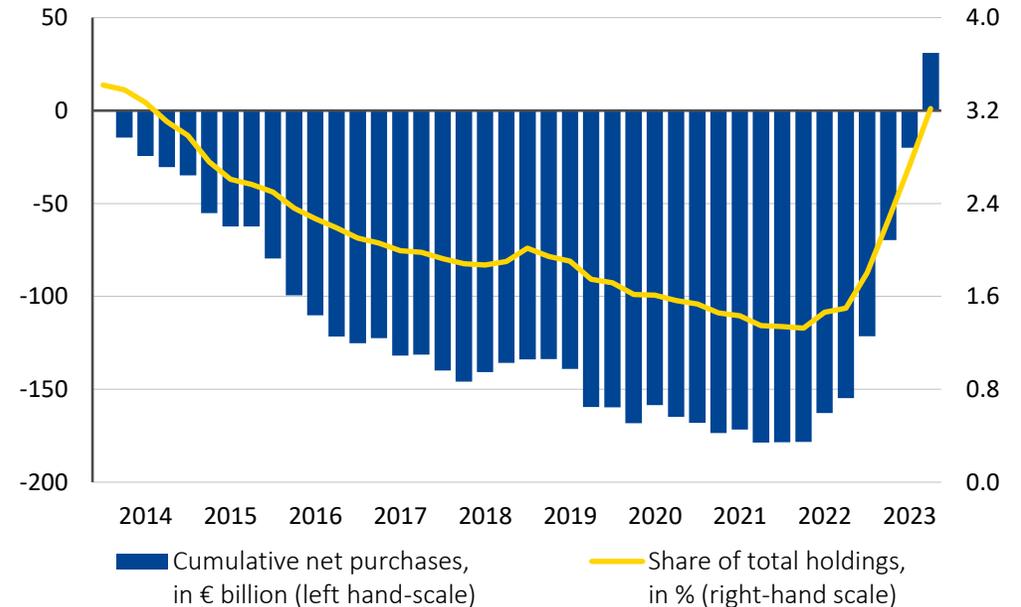
12-month cumulative debt portfolio flows (in € billion)



Note: Net balance is the difference between the purchases of euro area debt by non-residents (“inflows”) and purchases of foreign debt by euro area residents (“outflows”).
Source: ESM calculations based on European Central Bank data.

Households resurface as important buyers

Households’ holdings of government debt securities since 2013

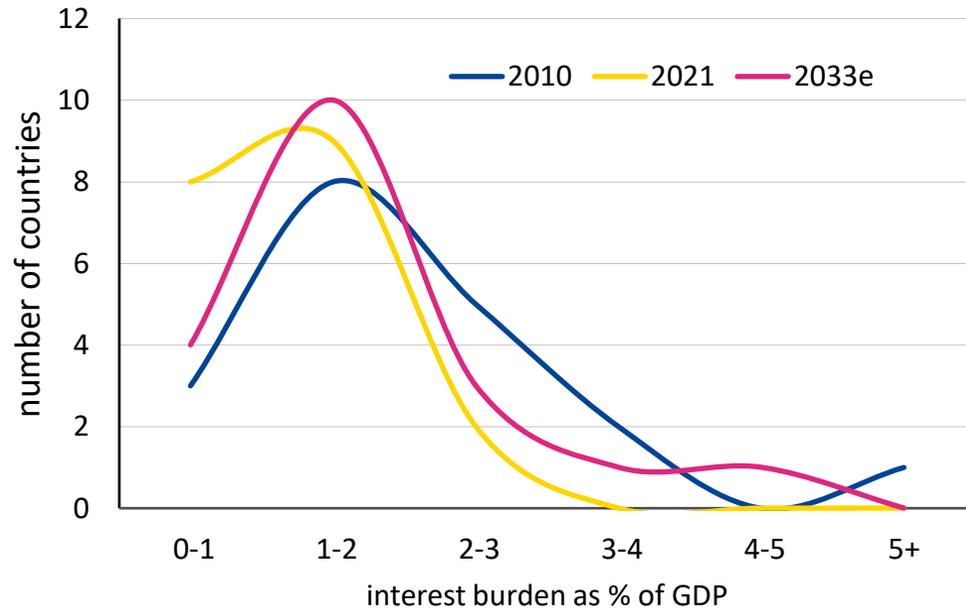


Notes: The chart reports the euro area households’ cumulative sum of net purchases (left-hand scale) since the last quarter of 2013 and their holdings’ share of general government debt securities issued by Germany, France, Italy, Spain, Belgium, Netherlands, Austria, Portugal, Greece, and Finland combined (right-hand scale). Both series end in the third quarter of 2023. Source: ESM calculations based on European Central Bank data.

INTEREST COSTS: DIFFERENTIATED IMPACT

Divergence of interest burden subject to debt level

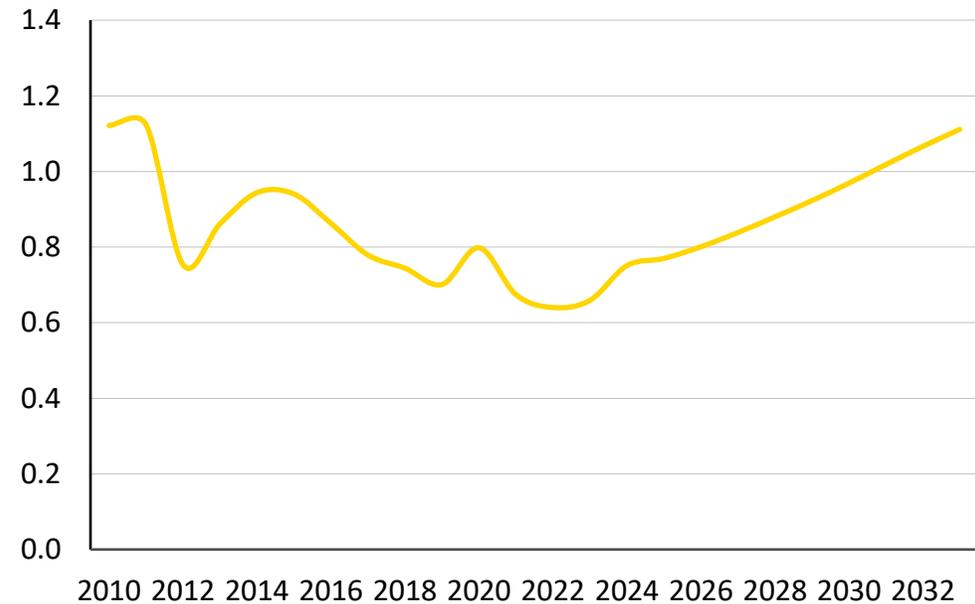
Member states by interest burden on market debt



Notes: For 2033e, the calculation is based on market forward rates as of 9 January 2024, assuming unchanged debt maturity composition. Maturing debt is rolled over at the forward rates of the average maturity of the portfolio. This mechanical exercise assumes that the primary fiscal balance (before interest payments) is zero, i.e. no additional deficit or debt repayment. Source: ESM calculations based on European Central Bank, Eurostat, and Bloomberg data.

Diffusion of interest burden

Standard deviation across member state as % of GDP



Note: The graph is based on marketable debt and market forwards. Assumes the same growth rate across countries, and no primary surplus/deficit. Source: ECB and Bloomberg.

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