

# Euro area Watch: Better than feared - weaker than hoped for

In the euro area, the preliminary result for GDP in the winter half-year 2022/23 was better than feared just a few months ago. However, this does little to change our assessment for the further course of economic activity. The underlying momentum is likely to turn out to be lower this year and next than some are hoping for. However, we are taking the available data as an opportunity to adjust our GDP forecast for 2023 and 2024.

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In the euro area, the **preliminary result for GDP** in the first quarter was **better than feared just a few months ago**, with growth of 0.1% qoq and 1.3% yoy respectively. The reasons for the better performance of the economy in the winter half-year 2022/23 are obvious. The **energy crisis was less drastic than assumed before the start of winter**. Firstly, a milder winter significantly dampened energy consumption. Secondly, the import conditions of important energy sources - keyword LNG - proved to be more flexible than feared. This meant that energy rationing was not an issue, but there were production cuts in individual sectors of the economy for price reasons. Based on the known country data, real domestic demand (private consumption and investment) probably declined in the first months this year. Thus, the slight increase in GDP is probably mainly due to the positive net exports.

The **results for the recent past do little to change our assessment of the further course of economic activity**. The **underlying momentum** is likely to be lower this year and next than some are hoping for. Admittedly, with a view to the energy markets, the downside risk for the coming period has diminished, too. However, energy prices for end customers have not yet normalized in many places and will still bring headwinds for consumers and businesses at least in the coming months. Most importantly, the energy price shock has long since spread into high inflation across all goods. Despite high employment (low unemployment) and significantly rising wages, private households can expect a loss of real income. Against this background, nominal consumer spending will continue to rise strongly, but the quantity of goods and services purchased will remain lacklustre. Furthermore, the increasing headwind from monetary policy must be taken into account. The skid marks on household loans point to a subdued development in private house building and consumption of durable consumer goods. The same applies to corporate lending and private investment. While short-term fiscal support against high inflation will fade out over time, the overall fiscal policy stance remains supportive. Many countries can draw on substantial resources from EU funds.

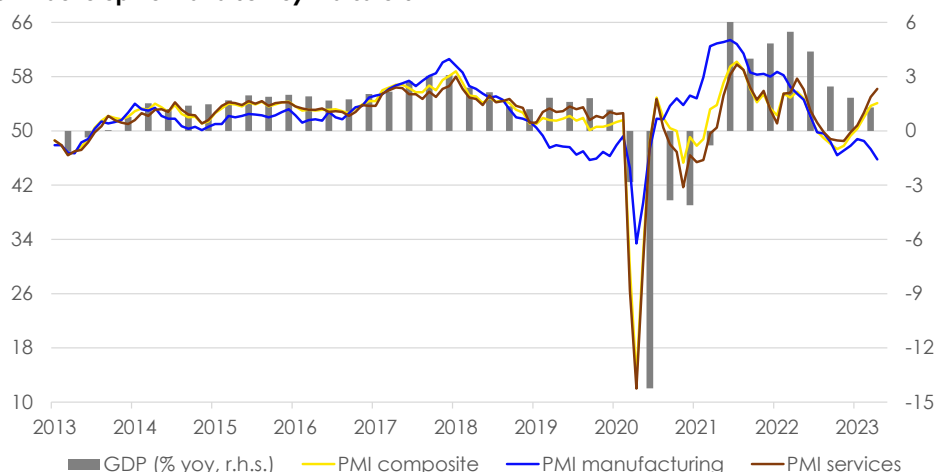
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## GDP development and survey indicators



PMI...Purchasing Managers' Index, values above (below) 50 signal increase (decrease) of economic activity

Source: Refinitiv, RBI/Raiffeisen Research

At the **sectoral level**, according to surveys of companies and given the anticipated environment, a two-tier economic development has to be expected, at least for some time. Industry is strongly dependent on the international economy. For the USA - an important global pacesetter - a restrained development is forecast, so that a vigorous recovery is not very likely. The domestically dominated construction sector faces double headwinds due to higher material costs and interest rates. In contrast, the outlook for (selected) services is positive. Service providers also face higher costs and labour shortages. However, the post-Corona swing-back of consumption from goods to services does not seem to be fully completed, which means that services should be the main contributor to GDP growth this year.

In sum, we **revise our estimate for GDP growth in 2023 upwards by 0.5 percentage points** due to the better winter half-year 2022/23. However, this past performance does not make us more optimistic about the underlying or future economic trajectory. Rather, the smaller energy downside shock in winter offers less potential for a temporary rebound in spring (e.g.: corona lock down and opening phases). This leads us to revise our **GDP forecast for the coming year downwards by the same amount.**

GD Forecasts	2023e	2024f
RBI new	0.8	1.5
RBI old	0.3	2.0
EU-Commission	1.1	1.6
ECB	1.0	1.6
Consensus (Focus Economics)	0.6	1.2

Source: EU-Commission, ECB, Focus Economics, RBI/Raiffeisen Research

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