ABN·AMRO

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Global Monthly

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Winter is coming

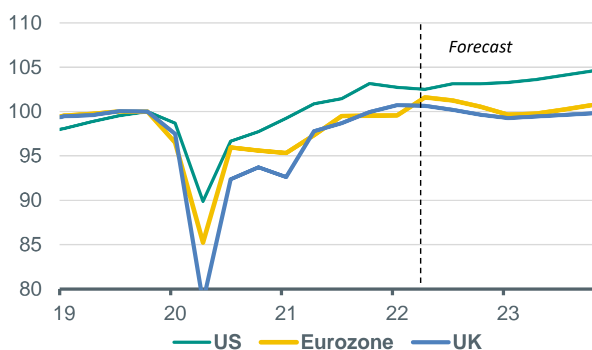
- **We expect the energy crisis to tip European economies into recession over the coming months**
- **Even if gas rationing is somehow avoided, sky-high energy prices, weak consumer and business confidence and tighter financial conditions will be enough to put growth into reverse**
- **The silver lining is that, outside of energy, weaker demand is helping to ease supply bottlenecks**
- **Regional updates: We describe our recent growth forecast downgrades for the *eurozone* and *the UK*, while in *the Netherlands*, we explain why the Q2 GDP strength is unlikely to last**
- ***The US* economy is also expected to go into recession, albeit a much milder one than in Europe**
- **The post-lockdown rebound in *China* should continue, but is constrained by the zero-covid policy**

Global View: A perfect storm is gathering over Europe

The summer holidays have been anything but quiet this year. Since our last *Global Monthly* at the end of June, the European energy crisis has intensified, as fears over shortages of natural gas conspired with an extended heatwave to push gas and electricity prices to new record highs. Russia did turn the Nord Stream gas tap back on after the pipeline's scheduled annual maintenance ended on 21 July, but at a reduced level. It has since threatened a further complete shutdown at the end of August, ostensibly for maintenance purposes. This has raised the risk of outright energy shortages over the winter period, with potentially crippling consequences for European industry. We said in our June *Monthly* that a gas shortage would trigger deep recessions in the eurozone and UK economies, and this has now become our base case. Even if Europe manages to avoid physical shortages of energy over the winter – for instance, if we are lucky enough to have a mild winter – the extreme prices for energy, weak business and consumer confidence, and tighter financial conditions are by themselves likely enough to push Europe into recession. Completing the not-so-pretty global macro picture, we expect a mild recession in the US on the back of high inflation and aggressive Fed rate hikes, while China's post-lockdown rebound is constrained by the continuation of its zero-covid policy, as well as turbulence in the real estate sector. The one bright spot is that, aside from energy, supply bottlenecks have continued to ease – providing some relief to global inflationary pressures.

Deep recession likely in Europe; a mild one in the US

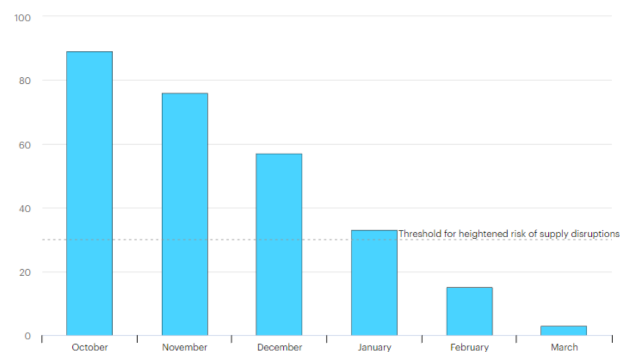
GDP, 100 = Q4 19



Source: Refinitiv

Disruption looks unavoidable with a full Russian stop

Potential evolution of EU gas inventories if Russia flows stop in October, %

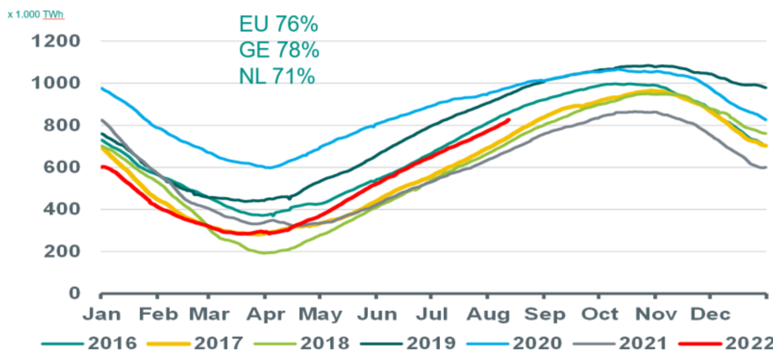


Source: IEA estimates

Filling gas inventories has come at a painful cost

European gas inventories are on track to meet the EU target of being filled to 80% by November – but at exorbitant cost: the price of gas has soared further over the summer, with the Dutch TTF 1 month ahead contract rising to over €300/Mwh – around 10x previous historic peaks. Inventories have been filled largely with the help of extra supplies of LNG, which have so far offset the shortfall from Russia. With constrained global supplies of LNG, this has meant energy shortfalls in less wealthy parts of the world unable to compete with the prices Europeans have been prepared to pay. We expect these high prices to push inflation even higher over the coming months, and even with relatively full inventories, the IEA estimates European countries could still face shortages to the extent that some rationing over the winter is necessary. Even in a positive scenario, Europe will still be heavily reliant on additional gas (mainly LNG) flows in the winter months, for which global competition could intensify further – potentially leading to even higher prices than we see today.

Gas inventories on track to meet EU 80% target

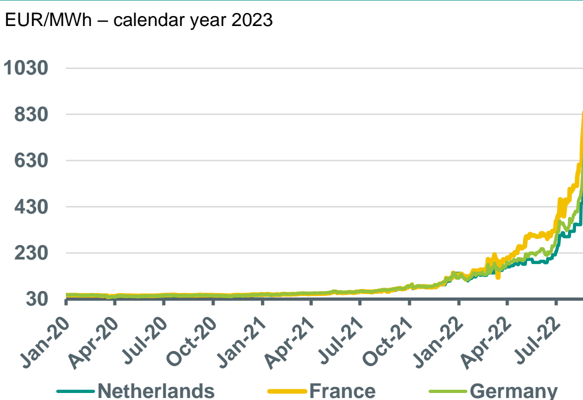


Source: Gas Infrastructure Europe

With baseload electricity supply in Europe also heavily dependent on natural gas (in the Netherlands, 60% of electricity is generated from gas), electricity prices have continued to surge in tandem. The sultry summer weather hasn't helped: aside from raising demand for electricity for air conditioning, higher temperatures in water sources used to cool reactors in France have led to nuclear outages, while low levels in the river Rhine in Germany have delayed coal shipments – hampering plans to raise coal-fired power generation to offset likely shortfalls in gas. The gradual increase in renewables capacity has done little to help – solar energy generation has naturally broken records in the sunny weather, but wind generation has been lower than normal.

Electricity prices have also continued to surge

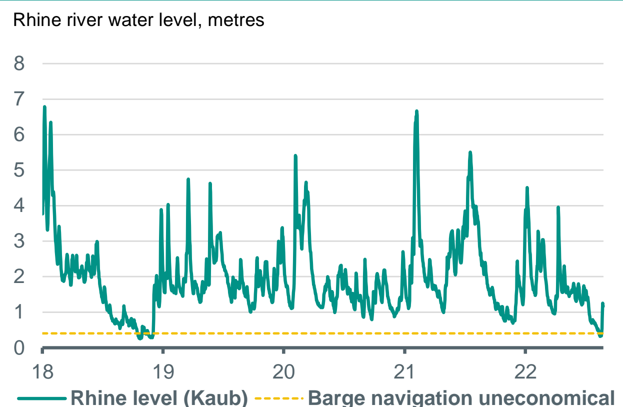
EUR/MWh – calendar year 2023



Source: Bloomberg

Low water levels in the Rhine river have not helped

Rhine river water level, metres



Source: Bloomberg, ABN AMRO Group Economics

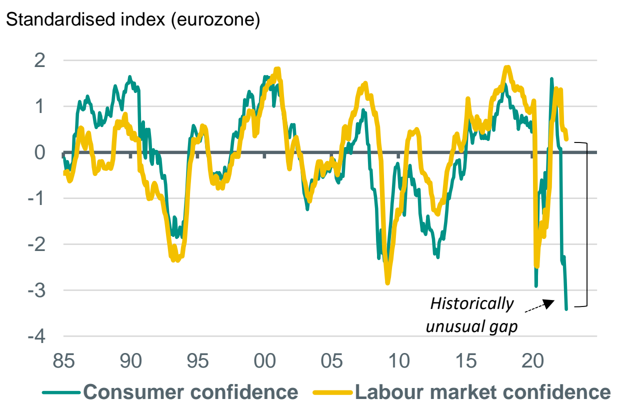
European recession looks baked in the cake – even if energy rationing is avoided

Whether Europe (the eurozone and UK) faces physical shortages of energy over the winter months remains highly uncertain, given that it is subject to many moving parts. Aside from the unpredictable actions of Russia, the degree to which industry is able to adapt and become more energy efficient is a crucial factor, as is the household response to higher energy

prices and government campaigns to reduce energy use. The IEA estimates that in the absence of a significant demand response by industry and households, even with gas storage levels at 90%, European industry would face disruptions (potentially involving a rationing of energy) by February if Russian gas flows were to stop completely from October onwards. Then there are the whims of the weather to consider – the severity of the winter could by itself mean the difference between energy rationing or not.

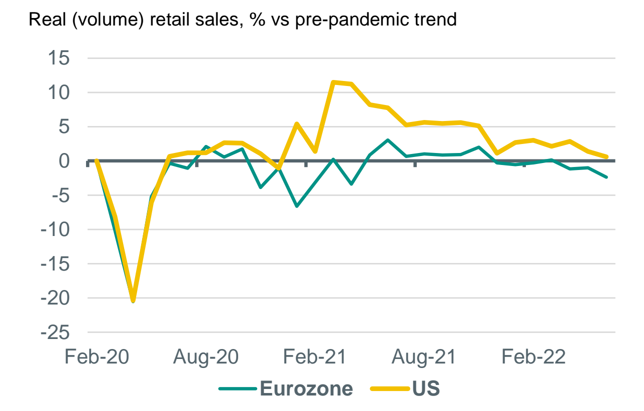
We think there are enough factors in play to induce a recession starting already in Q3. First, there is the price shock. Even if industry does not face a physical shortage of gas or electricity over the winter, the astronomical prices being faced can by themselves make some energy intensive businesses unviable, and there have been numerous examples of this over the past year: one of Europe's largest zinc smelters in the Netherlands will completely halt production in September due to high energy prices. Aside from the direct production loss impact on GDP of such closures, there is also the knock-on effect through the supply chains if reduced production cannot be easily sourced from outside Europe – and even if it can, likely at a (potentially much) higher cost.

Consumer confidence has plummeted



Source: Refinitiv, ABN AMRO Group Economics

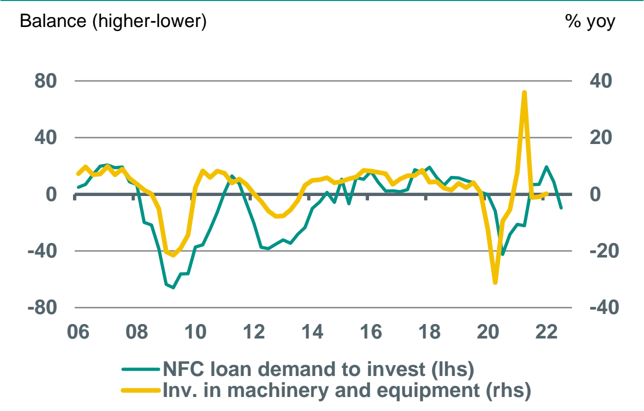
Retail sales have fallen in recent months



Source: Refinitiv, ABN AMRO Group Economics

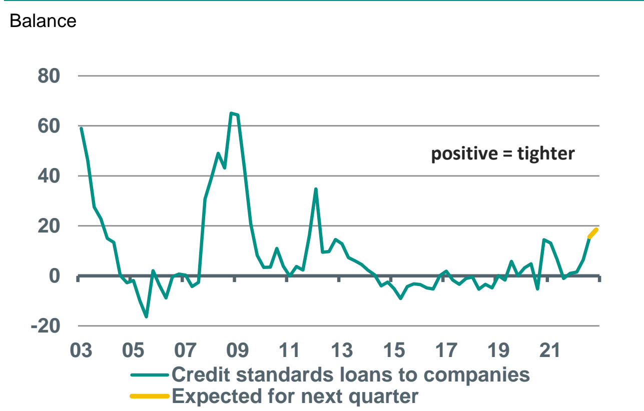
Then, there is the inflation shock to real incomes. We have raised inflation forecasts further on the continued rise in energy prices, with eurozone inflation now expected to average 8.3% this year and 4.4% next year. High inflation is already hitting consumption of goods – as indicated by falling retail sales in recent months – and it is likely to increasingly weigh on the services recovery. This is consistent with plummeting consumer confidence, which is now already lower than during the first lockdowns of the pandemic in April 2020. Confidence in the labour market has so far prevented a severe downturn in consumption, but this has now started to turn, and we expect rising unemployment later this year to become an additional drag on consumption.

Loan demand slumping, suggesting investment will fall



Source: Refinitiv, ECB BLS, ABN AMRO Group Economics

Bank lending standards have tightened



Source: Refinitiv, ECB BLS, ABN AMRO Group Economics

A further factor driving our recession call is the dramatic deterioration in business confidence, as signalled by the PMIs and other confidence indicators. In particular, PMIs suggest a significant softening in demand, with businesses citing cost of living pressures as the cause, leading to rising unsold goods and reduced activity in some parts of the services sector. Against this backdrop, financial conditions have continued to tighten. The ECB's most recent Bank Lending Standards survey pointed to both reduced demand for loans as well as tighter lending standards, with eurozone banks adopting stricter criteria in their assessment of both household and business loan applications. Lenders cited both increased economic uncertainty and less accommodative monetary policy as the main drivers. With the ECB and BoE unlikely to relent in their inflation fighting rate hike cycles in the near term, there is little prospect of any easing in financial conditions driving an improvement in growth prospects. On the fiscal side, government support is to some extent acting as a stabiliser to activity and preventing a more severe downturn, but it is unable to fully offset it, with inflationary pressures and higher interest rates restraining political appetite to aggressively support growth.

All told, the combination of weaker demand, weaker confidence, and tighter financial conditions suggests investment is likely to decline alongside consumption over the coming quarters. We therefore expect a recession in both the eurozone and UK economies over the coming quarters, with GDP declines in 2023 of 0.9% in the eurozone and 0.8% in the UK.

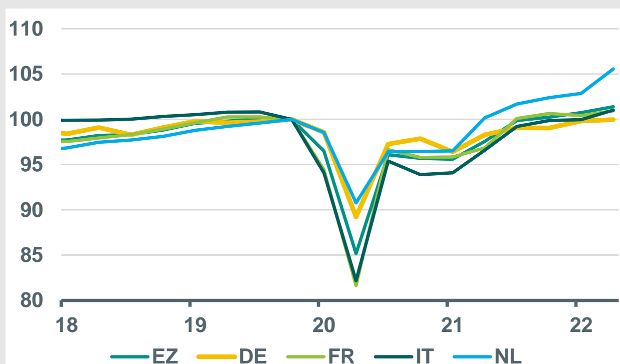
Recession will be more shallow in the Netherlands

The Netherlands can be viewed as a bright spot, compared to other eurozone countries. The Dutch economy still benefits from significant catch-up growth in (services) consumption and investment following the lockdowns at the start of the year. That said, not all of the recent growth was pandemic-related. There continues to be strong demand for Dutch export products, particularly machinery and chemicals, which has driven export growth. These factors contributed to the Netherlands having the highest growth rate of all eurozone countries in the second quarter (+2.6% qoq).

This does not mean that the many headwinds stemming from (energy) inflation, gas shortages and monetary tightening won't also hinder the Dutch economy going forward. We expect growth to slow considerably over the second half of 2022, ultimately leading to a shallow recession starting in Q4. As inflation erodes disposable income, we expect consumers to cut back spending, which would bring consumption more in line with consumer sentiment. Softening demand, particularly in major trading partners such as Germany will hurt external demand, as Dutch businesses already anticipate in recent survey results. The smaller share that Dutch industry – which will bear the brunt in case of energy rationing – has in the economy compared to Germany is also a reason why the contraction in the Netherlands will be less deep than in the eurozone. Furthermore, the historically tight labour market, which held back growth in recent months will act as a cushion going forward, providing job security and thereby providing support to consumption and the housing market. The Netherlands cannot escape recessionary forces. But, we expect the downturn to be less severe than what we expect for the broader eurozone.

The Netherlands has outperformed eurozone peers

GDP index, Q4 19 = 100



Source: Refinitiv, ABN AMRO Group Economics

US also likely to go into a recession, albeit a much milder one

We have also downgraded our growth outlook for the US economy, following the negative Q2 GDP reading and given much weaker prospects for an investment rebound. The looming recession in Europe by itself has a relatively limited impact on the US outlook, given that the US's dependence on exports generally is low, and given that to some extent US exports will actually benefit from Europe's energy crisis in the form of higher LNG exports. If anything, the main channel through which Europe's energy crisis might impact the US is by further lifting inflation, due to the upward pressure higher LNG demand is putting on domestic gas prices. While nowhere near the stratospheric highs seen in Europe, US natural gas prices are still some 2-3x typical peak prices seen prior to the pandemic. Like Europe, the main driver of the expected weakening in the US economy is the inflation hit to real incomes – which is less severe than that seen in Europe, given that nominal wage growth is higher – as well as much tighter monetary policy from the Fed. We had already expected broadly stagnant consumption over the coming quarters on the back of these factors, and we now expect this to be accompanied by a much shallower recovery in investment. While the US might narrowly avoid two consecutive GDP contractions, we expect the weak growth environment to drive a darkening in labour market prospects, with the unemployment rate expected to rise by around 1.5pp to close to 5% by the end of 2023. This is likely to meet the NBER's official definition of a recession by the second half of next year. However, the expected US recession is unlikely to be as severe as what we expect to see in Europe. All told, we expect GDP growth of 1% in 2023, slowing from a marked down expectation of 1.7% growth in 2022.

Headwinds to China's post-lockdown rebound do have a silver lining

In contrast to advanced economies, China's economy is likely to continue to rebound over the coming quarters from the strict lockdowns seen earlier this year, although the pace of that rebound is being constrained by a continuation of the government's zero-covid policy and – more recently – turbulence in the real estate market. In more normal times (think back to 2017-18), worries over potentially weaker growth in China would clearly weigh in our assessment of the eurozone outlook in particular, given its dependence on exports to China. However, in the current environment dominated by energy supply risks and massive declines in real incomes, the impact of potentially weaker export growth to China is comparatively small. If anything, worries over weaker demand in China are providing some relief to elevated global commodity prices, acting as a welcome counter to sky-high gas prices.

Is there anything to be happy about? At least supply bottlenecks are easing

If there is one reason to be happy about how the global economy is evolving at present, it is that – gas supply crunch aside – supply bottlenecks generally are easing significantly. This is clearly evident in our global supply bottlenecks index, which has plummeted over the past couple of months, driven by a much improved supply-demand balance for goods as indicated by the global PMIs, as well as continued falls in global shipping freight tariffs. Recessions in advanced economies are likely to drive a further improvement in the supply-demand imbalances we have seen, which should ultimately feed through to lower inflation – at least from the goods side of things. For services inflation, the expected weakening in the labour market is likely to play a more important role, and this will be the focus of central banks as they monitor the impact of interest rate rises in restraining activity. (Bill Diviney, Aline Schuiling, Hans van Cleef, Jan-Paul van de Kerke, Arjen van Dijkhuizen, Aggie van Huisseling)

Our global supply bottlenecks index has eased sharply

Index (+6 = maximum bottlenecks)

Source: ABN AMRO Group Economics, Bloomberg, Refinitiv

Most commodity prices have fallen in recent months

Index, 100 = January 2020

Source: Bloomberg, ABN AMRO Group Economics

Eurozone: Recession now our base case

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- **Our base scenario for the eurozone economy now includes a recession in the coming quarters**
- **The ECB's focus will continue to be on suppressing longer-term inflation expectations. It is expected to hike rates by 50bp in September and by 25bp each in October and December.**

After the annual maintenance to the Nord Stream 1 pipeline in July, gas flows from Russia clearly have not returned to the levels that would prevent an energy crisis in the eurozone. As we have mentioned in earlier publications, a decline in Russian gas supplies that is roughly in line with current flows would result in ongoing high energy price inflation and would also probably require significant reductions in gas usage in industry.

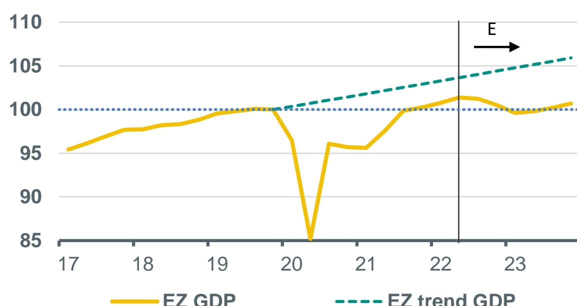
The recent jump in gas prices should add to the already very high inflation rate in the coming months. We have raised our forecast for average inflation in 2022 to 8.3%, up from 7.4% and in 2023 to 4.4%, up from 3.7%. As a result, households' real disposable income will drop by more than we estimated earlier. Some of the blow to income and consumption could be limited by government support measures, but we expect these to be too limited to prevent consumption from contracting. What is more, it seems that consumers have already spent most of the excess savings that they accumulated during the pandemic. Indeed, GDP growth came in higher than expected in Q2 (at 0.6% qoq). Although the details have not yet been published, private consumption probably grew robustly despite a sharp drop in real income, implying that spending was largely financed by dissaving. Finally, consumption should be hit by deteriorating labour market prospects. The tightness in certain segments of the labour markets after the pandemic, will soon evaporate as labour supply will be encouraged by the high inflation rate and erosion of real income, while labour demand declines on the back of the deterioration in economic conditions. Meanwhile, fixed investment and industrial production could still expand in Q3, as backlogs due to previous disruptions in supply chains are being cleared. However, the tightening of financial conditions and the significantly weaker global economic outlook should result in a contraction in investment from the final months of the year onwards. Moreover, firms will likely see their margins being squeezed, which should be an extra drag on investment and hiring going forward.

All in all, we have pencilled in a modest decline in GDP in Q3 and two consecutive more significant contractions in 2022Q4 and 2023Q1. Our annual average growth forecast drops to 2.7% in 2022 (down from 2.9% previously) and to around -1% in 2023 (down from +1.3% previously).

In such a recessionary economic environment, the ECB would probably normally stop hiking rates at an early stage or even start easing policy. However the high level of inflation is expected to encourage the central bank to continue hiking until the end of the year, as it is committed to fight against any potential rises in longer-term inflation expectations. Therefore, we continue to expect another 50bp hike in September, to be followed by two hikes of 25bp each in October and December. After that, we expect the central bank to keep rates on hold for a while. The risks to our forecast for ECB policy are skewed to more rate hikes in the 3-6 month horizon, given that the ECB's focus is currently on inflation rather than growth.

Recession on the cards

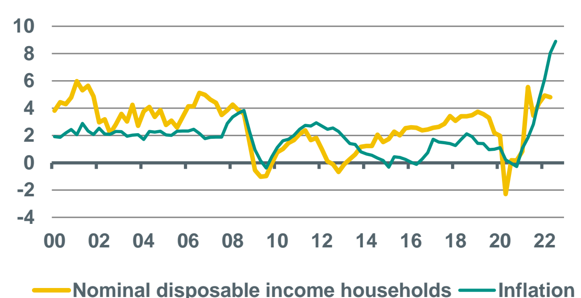
Index, 2029Q4 = 100



Source: Refinitiv, ABN AMRO Group Economics

Real household income sharply lower

% yoy



Source: Refinitiv, ABN AMRO Group Economics

The Netherlands: Despite strong Q2 growth we expect a slowdown

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- **Q2 growth (+2.6% q-o-q) surpassed expectations; given headwinds this momentum is unlikely to last**
- **We have revised our forecasts downwards, now including a small recession starting in Q4**
- **We expect 2022 growth to be 4.7% and 2023 growth to slow to 0.5%**

Last week's Q2 GDP data yielded an upward surprise. Quarterly growth was expected to be positive, but only marginally. Instead, qoq GDP growth came out at a whopping 2.6%. This pushed the level of GDP even above the pre-Covid trend level (see left figure). All subcomponents surprised to the upside, but investment (+5.2% qoq) and exports (+2.7% qoq) stood out in particular. For investment this was a welcome catch-up after it had been lagging GDP growth since mid-2021 when supply bottlenecks intensified. Investment in transport equipment was a particularly strong driver. Exports were driven by a further catch-up in services exports, partially on a return of tourists to the Netherlands, but strength was also visible in machinery and chemicals. Due to Covid-induced economic volatility, the difference between first and final official GDP estimates have been significant in recent quarters. The initial GDP estimate could therefore be revised downwards in future.

This 2nd quarter growth is the highest among eurozone peers as indicated in this month's *Global View*, and provides a solid basis for the many headwinds (inflation, margin squeeze, lower external demand) that are intensifying. Indeed, we expect the economy to slow down in the second half of 2022 and to ultimately cause a shallow recession starting in Q4, but to a lesser extent than we expect for the broader eurozone. This is for several reasons. One is already illustrated above: the Dutch economy has higher growth momentum going into the remainder of the year. Secondly, the large swathes of unfilled demand in terms of new orders for businesses but also in the labour market act as cushions. In the labour market, this strong demand faces supply limits as showcased by the very low unused labour potential (see right figure). Sectoral compositions also matter, but given the smaller share of Dutch industry in the economy – which will bear the brunt of ever rising energy prices – we expect the contraction in Q4 and Q1 of 2023 to be less deep than in Germany, for instance.

GDP above pre-covid trend

Index; Q4 2019 = 100; trend growth is 1,5%

Source: ABN AMRO, CBS

No relief expected from labour supply

Unused labour potential summed, ages 15 – 75, x 1000 individuals

Source: ABN AMRO, CBS

We expect growth to slowly pick up after a further small contraction in the first quarter of 2023. This should lead to average annual 2022 growth of 4.7%, with 2023 growth slowing to 0.5%. As such, these forecasts incorporate a small recession at the end of 2022 and beginning of 2023. In September, at *Prinsjesdag*, the governmental budget for next year will be announced. It is planning on implementing a range of measures to boost purchasing power in 2023. High Inflation and the marginal pickup we have seen in wage growth means a sharp drop in purchasing power of roughly 7% is on the cards for 2022. The expected 2023 measures, if sufficient, can lower the negative effects that inflation has on purchasing power and dampen the consumption effect.

On the back of ever rising energy prices and continued rises in food prices we have increased our inflation forecasts from 8.5% for 2022 and 4.3% for 2023 to 10% and 5% (HICP), respectively. This not only reflects rises in headline inflation but also in core inflationary pressures. We see more evidence of the broadening of inflation, especially in core services which are energy intensive and/or rely on food inputs, such as transport services or restaurants.

US: Heading for a mild recession

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- **We have lowered our growth forecasts on the back of a significantly weaker recovery in investment**
- **We expect unemployment to begin rising in Q4, with a recession likely to be declared in H2 2023**
- **Despite this, the tight labour market and inflation worries mean that we still expect the Fed to hike interest rates aggressively over the coming months – taking the fed funds upper bound to 4%**

In light of the negative Q2 GDP print and weakening prospects for an investment rebound, we have lowered our GDP forecasts – particularly for 2022 but with a less marked revision for 2023. While the main drag on Q2 GDP was weaker inventory accumulation, an additional factor was unexpected declines in fixed investment – particularly structures and housing. As such, we have significantly marked down our expectations for an investment rebound on the back of pent-up demand in the manufacturing and housing sectors; all told, we have halved our forecast for fixed investment to just 2.5% for 2022, down from 5% previously, and made a more modest downward adjustment for 2023 to 1.9% from 3.3% previously. Our expectation for stagnant consumption in H2 2022 remains broadly unchanged. This takes our overall GDP forecast for 2022 down to 1.7% from 2.2% previously, and to 1.0% from 1.3% previously. Previously, we expected significant unfilled demand for goods and housing to lead to strong investment growth in the second half of 2022, as supply-side bottlenecks had been the chief impediment to growth. While we still expect some rebound from the negative investment reading in Q2, a range of manufacturing surveys suggests a more rapid cooling in demand than we had previously expected, and combined with higher interest rates and rapid input cost growth, this is likely to mean a much shallower recovery than previously looked likely. Manufacturers (especially car makers) are caught between continued unfilled current demand on the one hand, and an expected cooling in consumption as the inflation hit to real incomes is increasingly felt. The latter is likely to weigh more heavily in investment decisions, particularly as we move into 2023.

According to the technical definition of two consecutive quarters of GDP declines, the US economy was already in recession in the first half of 2022. However, on most other measures, the economy has clearly not been in a recession – in particular, job gains have continued to be robust, and consumption has continued to grow, albeit more slowly. Ultimately, we expect unemployment to rise c.1.5pp to around 5% by end 2023, with the NBER calling a recession perhaps in H2 2023. Note, a recession can be declared even in the absence of two consecutive GDP declines, as we saw in the early 2000s.

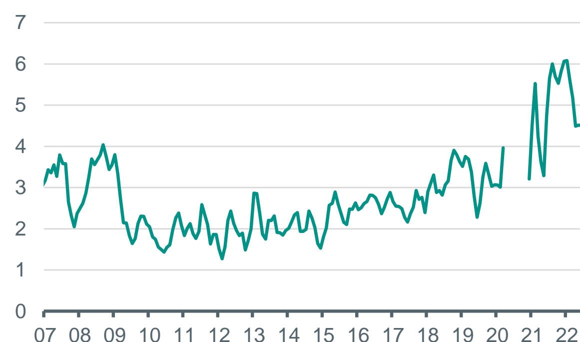
Surveys point to a cooling in manufacturing demand

PMI, index; >50 = expansion, <50 = contraction

Source: Refinitiv, ABN AMRO Group Economics

Wage growth remains inconsistent with 2% inflation

Average hourly earnings, % 3m/3m saar



Source: Refinitiv, ABN AMRO Group Economics

Despite the weaker growth outlook and the expected rise in unemployment, we expect the Fed to continue raising interest rates aggressively over the coming months. While we have lowered our headline inflation forecasts somewhat, this is largely on the back of lower oil prices than we expected at this point in the year, with our core inflation forecasts actually seeing a modest upward revision. A key pipeline pressure here is wage growth on the back of the tight labour market. The July employment data showed a renewed pickup in wage growth and an upward revision to the June data, taking 3m/3m average hourly earnings growth up to 5% - well above levels consistent with the Fed meeting its 2% inflation target. With the Fed keen to avoid declaring victory in its inflation fight too prematurely, we think it will need to see both lower realised inflation and a cooling in wage growth before it is confident the inflation hump has passed. We are still a long way from that.

UK: In the early stages of a wage-price spiral

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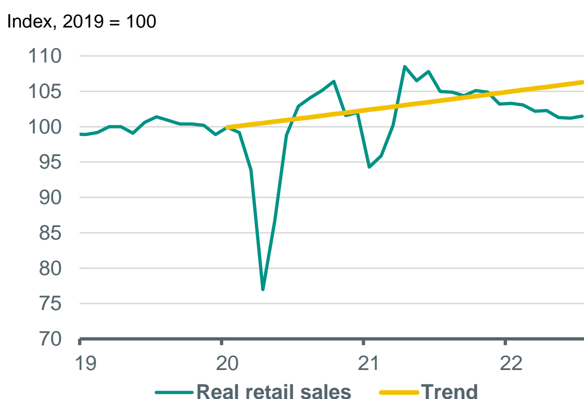
- **The real income shock is pushing the economy into a recession that is likely to persist into 2023**
- **Inflationary pressures have intensified, with the economy looking to be in the early stages of a wage-price spiral. As such, we now expect the BoE to hike rates by 50bp at the coming two meetings**

The economy performed marginally better than expected in Q2, as weakness in private and government consumption was offset by a continued strong inventory buildout. However, the economy still contracted by 0.1% overall, and we expect that contraction to continue over the next few quarters. While some rebound in private consumption is likely in Q3, on the back of the post-pandemic summer travel surge, in other respects demand continues to weaken on the back of the inflation shock to real incomes, and this is likely to lead to much lower levels of inventory accumulation – with outright declines likely later this year and into 2023. The inflation shock is expected to intensify, with Ofgem's 80% announced rise in the energy price cap pushing inflation more firmly into double-digit territory when the cap is officially raised in October (as of July, inflation had reached 10.1%). Ofgem is shifting to a 3 month cycle for its energy price cap changes, with the next move therefore due in January (previously, the cap was adjusted every 6 months). Given the most recent surge in wholesale gas and electricity prices, we expect inflation to see another lift in early 2023 – and ultimately for it to peak at over 13%. Similar to the eurozone, we expect the inflation hit to real incomes and the burden of astronomical energy prices on business to drive a deep recession in the UK, with a contraction of -0.9% now expected in 2023.

The announcement of the new Prime Minister on 5 September is unlikely to help. Current opinion polling suggests foreign secretary Liz Truss is likely to comfortably win the Conservative Party leadership contest against former chancellor Rishi Sunak. Her stated policy is to implement a raft of tax cuts upon becoming PM, providing stimulus to the economy just when the Bank of England is trying to push in the opposite direction by raising rates to dampen demand. Indeed, the ultra-tight labour market has led to a further pickup in wage growth recently, with the UK now seemingly in the early stages of a wage-price spiral, as higher wage pressures push companies to pass on higher costs evident in the rise in core inflation. Tax cuts would add fuel to the inflationary fire, and while they might make the expected recession in the UK more shallow than otherwise, they will not help the economy avoid a recession entirely (see this month's Global View for more).

Inflation driving a retail volume slump



Source: Refinitiv, ABN AMRO Group Economics

Wage growth has continued to accelerate

Source: Refinitiv, ABN AMRO Group Economics

As a result of the worsening inflation situation, and the increasing role that the labour market is playing, we now expect the Bank of England to hike its policy rate by another 50bp when it next meets on 17 September – taking Bank Rate to 2.25%. Subsequently, we expect another 50bp hike in November, followed by a final 25bp hike in December. As such, we now expect Bank Rate to peak at 3% by the end of this year, compared with our previous expectation of 2.5%. Our new forecast is still well below market pricing, which foresees rates rising above 4% by early next year. Our view assumes the BoE's own longer term projections are realised, as these suggest such a sustained high level of interest rates would lead to an even deeper recession than we currently forecast, with inflation significantly undershooting the Bank's 2% inflation target by 2024. With this in mind, we continue to think the Bank will start cutting rates back again late next year, assuming that inflation and labour market tightness have sufficiently cooled at that point.

China: Beijing steps up policy support as drags build

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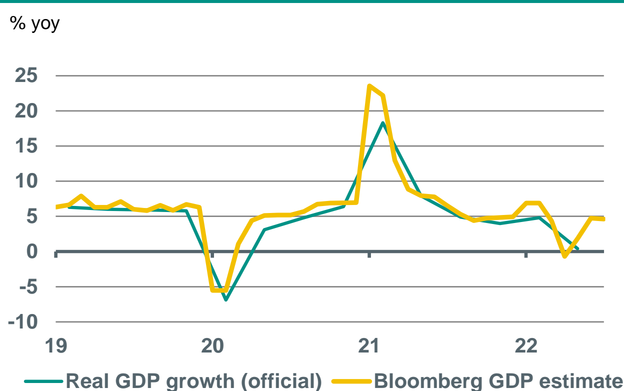
- **Our annual growth forecast for 2022 (3.7%) almost 2 %-point below Beijing's official growth target**
- **Headwinds from Covid-19 policy, real estate and power shortages constrain post-lockdown rebound**
- **Beijing resumes piecemeal monetary easing, steps up real estate and broader support as expected**

Last month, partly reflecting a GDP contraction in Q2 of -2.6% qoq, we cut our 2022 growth forecast to 3.7% (from 4.2%) – see here. The official growth target for this year (5.5%) will remain out of reach. Reflecting payback from the Q2 slump (and with exports outpacing imports), we still expect above-trend qoq growth in 2H-2022. That also assumes the overall lockdown intensity will remain lower than in March/April, despite recurrent virus flare-ups, and additional policy support. Still, China's rebound will be unbalanced, bumpy and less spectacular than the recovery from the initial Covid-19 shock in 2020, with key headwinds from strict Covid-19 policies and property sector woes remaining, and a slowdown in global growth adding risks.

Post-lockdown rebound constrained by drags from Covid flare-ups, real estate woes and power shortages
PMI and activity data published over recent months do confirm a post-lockdown rebound. That said, disappointing July data illustrate that the strength of this rebound is constrained by ongoing headwinds from pandemic flare-ups and strict Covid-19 policies (characterized by 'mass testing and mini lockdowns under dynamic clearing') combined with distress from the property sector. The rebound is again led by the production side, with authorities having prioritized the normalization of production and transport chains above supporting consumption. Still, Covid-19 flare-ups and power shortages (heatwave-related, not policy-induced like last year) have hampered the rebound in industrial production. Retail sales slowed to 2.7% yoy in July (June: 3.1%), with Covid-19 policy leaving its mark on consumer condicence. Property sales are still in the doldrums, with more property developers facing financing problems to finish construction projects (see below). Fixed investment slowed to 5.7% yoy ytd (June: 6.1%), with property investment once more contributing negatively. While the unemployment rate dropped further in July, to a six-month low of 5.4%, youth unemployment rose to a record high of 19.9%.

Post-lockdown rebound less spectacular than in 2020

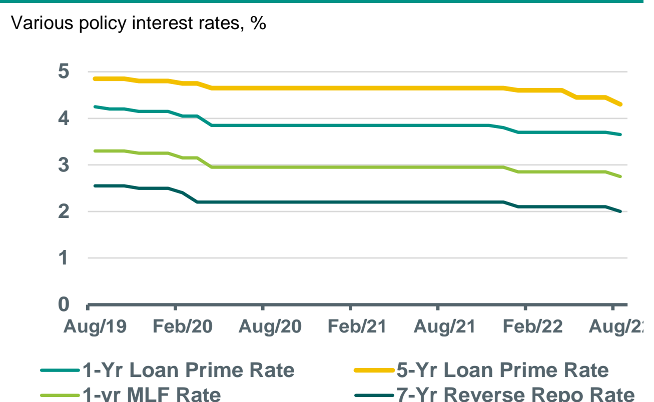
% yoy



Source: Bloomberg

PBoC resumes piecemeal monetary easing

Various policy interest rates, %



Source: Bloomberg

PBoC resumes piecemeal monetary easing and takes wider measures to safeguard growth and support real estate
As we highlighted in previous publications, property sector woes have continued to spread. The erosion of confidence among home-owners that construction projects will be finished has triggered a boycott of mortgage repayment obligations. The pick-up in credit growth has also stalled due to weak mortgage demand. Recent measures taken are in line with our view that the PBoC would resume piecemeal monetary easing and would step up broader support, including to the property sector. In recent weeks, the PBoC resumed mini cuts of a number of policy rates, with a particular focus on the 5-Year Loan Prime Rate that functions as a benchmark for mortgage rates. Next to the rate cuts, Beijing will offer special loans (CNY 200bn) to developers so that they continue finishing projects. Also, the PBoC is urging state banks to step up lending to the real economy, including to the property sector. In late August, local governments were given more freedom to use city-specific policies to support real estate. The latter measure was one of the 19 elements of a broader CNY 1trn (USD 150bn) stimulus package aimed at supporting investment and consumption and stabilizing the property markets.

Key views on a page

The energy crisis in Europe is intensifying, and we now expect deep recessions in the eurozone and UK economies. Consumption growth is being weighed by the biggest fall in real incomes in decades, while industry is being hampered by sky-high energy prices and worries over potential shortages as we move into the winter months. Elevated energy prices and supply disruptions are delaying the normalisation in inflation, raising the risk that it becomes more entrenched. Upside inflation risks mean the Fed is likely to continue raising rates rapidly at coming meetings. The ECB is expected to continue tightening policy, with rates moving into positive territory by September. Europe will also continue to feel the global spill-over effects of tighter US monetary policy, pushing bond yields higher, equity markets lower, and weighing further on activity.

Macro	Central Banks & Markets
Eurozone – The economy is expected to move into recession in the coming quarters. We have pencilled in a modest contraction in GDP in Q3 and two more significant contractions in 2022Q4 and 2023Q1. Our annual average growth forecast drops to 2.7% in 2022 (down from 2.9% previously) and to around -1% in 2023 (down from +1.3% previously). Domestic demand will be hit by ongoing very high (energy) inflation and tightening financial conditions, which will also reduce job growth and fixed investment. Exports will suffer from slower world trade growth.	**ECB** – Following the 50bp rate hike at the July meeting, and the introduction of the new Transmission Protection Instrument (TPI), we expect another 50bp rate hike in September. Next, two more hikes of 25bp each are expected in October and December, when the discount rate should reach 1.00%. We have not pencilled in any rate hikes after that as the economy is expected to move into recession. The risks to our forecast for ECB policy are skewed to more rate hikes in the 3-6 month horizon, given that the ECB's focus is on inflation rather than growth.
Netherlands – Second quarter growth in 2022 surprised to the upside with 2.6% qoq. This was particularly driven by investment, which had been lagging behind due to supply bottlenecks and labour shortages, and catch-up growth in (services) consumption. Considering the many headwinds from (energy) inflation, gas shortages and monetary tightening, the Netherlands cannot escape a small contraction at years end. But, we expect the contraction to be less severe than for the broader eurozone, partially due to the historically tight labour market.	**Fed** – Given persistently elevated inflation in the US, and upside risks to the outlook, we expect the Fed to hike rates a further 50bp in September, with risks tilted to another 75bp move. We continue to expect the upper bound of the fed funds rate to reach 4% by February. Subsequently, we expect the Fed to pause, assuming inflation is moving back towards its 2% target. Risks are to the upside, both in the rate hike pace and in the terminal rate. The Fed begun unwinding its balance sheet in June, initially at a $47.5bn monthly pace, doubling to $95bn from September.
UK – Inflation rose to 10.1% in July, and is set rise further in October following revised household energy cap from Ofgem, which will lead to energy bills rising by 80%. The economy contracted slightly in Q2, and we expect this contraction to continue over the coming quarters, with the unemployment rate likely to start rising from late this year onwards. The labour market remains strong for the time being, with inflation driving bigger pay settlements, suggesting the economy may be in the early stages of a wage-price spiral.	**Bank of England** – The growing risk of a wage-price spiral in the UK led the MPC to hike rates by 50bp at the August meeting. We expect now expect further 50bp hikes in September and November, with Bank Rate to peak at 3.0% by year end. We think that by next year, the economy should have sufficiently weakened to drive a rise in unemployment and a cooling in wage growth. Combined with a broader fall in inflation in the second half of next year, this could raise the prospect of the MPC reversing course and cutting rates, perhaps in late 2023.
US – Despite the contraction in GDP in Q2, demand indicators overall have been solid – particularly private consumption and jobs growth. We expect underlying demand to slow significantly in H2 and into 2023, as the decline in real incomes and interest rate rises begin to bite. Soft demand is likely to push the unemployment rate higher, with the NBER likely to declare a recession next year. Risks to inflation continue to be to the upside, potentially requiring even bigger interest rate rises to bring back down.	**Bond yields** – Given our macro revisions, we expect both Treasury and German bonds to rally from Q4 until mid-2023. We expect the 10y US Treasury yield to slide to 2.55% in Q4 2022. Similarly, we expect 10y Bund yield to fall to 1.1% by Q4 due to US spill-over effects and markets shifting back to risk-off mode, increasing safe-haven demand. However, as short-term inflation expectations continue to rise, we expect a stronger inversion of the Treasury curve and the Bund curve to bear-flatten in the near-term before steepening again in H2 2023.
China – Last month, we cut our 2022 annual growth forecast to 3.7%, almost 2 %-points below Beijing's target. Largely reflecting payback from the Q2 lockdown slump, we still expect above-trend sequential growth in 2H-2022. This also assumes the nationwide lockdown intensity to remain lower than in March/April and Beijing to continue with additional support, including for the property sector. China's post-lockdown rebound will be less spectacular than in 2020, given headwinds from strict Covid-19 policy, real estate woes, power shortages and weak global growth.	**FX** – On 17 August we made a modest adjustment in our forecasts. A recession in the eurozone combined with a more aggressive path of rate hikes in the US compared to the eurozone will probably keep the euro under pressure versus the US dollar this year. But we still think that a sustained move in EUR/USD below parity will be difficult. Therefore, we keep our forecasts for EUR/USD for end 2022 at 1.0. In 2023 we expect narrowing yield spreads between the US and Germany to support the euro, with our end-2023 forecast at 1.10 (was 1.15).

Main economic/financial forecasts

GDP growth (% yoy)	2020	2021	2022e	2023e	Inflation (%)	2020	2021	2022e	2023e
United States	-3.4 ↓	5.7 ↓	1.7 ↓	1.0	United States	1.2	4.7 ↑	8.4 ↑	4.2
Eurozone	-6.5 ↓	5.3 ↑	2.7 ↓	-0.9	Eurozone	0.2	2.6 ↑	8.3 ↑	4.4
Japan	-4.6 ↑	1.7 ↓	1.3 ↓	1.5	Japan	0.0	-0.2 ↑	2.0 ↑	1.5
United Kingdkom	-9.3 ↑	7.4 ↓	3.1 ↓	-0.8	United Kingdkom	0.9	2.6 ↑	9.2 ↑	8.4
China	2.2	8.1 ↓	3.7 ↑	5.6	China	2.5	0.9	2.5 ↑	2.5
Netherlands	-3.9 ↓	4.9 ↑	4.7 ↓	0.5	Netherlands	1.1	2.8 ↑	10.0 ↑	5.0
Policy rate	**25-8-2022**	**+3M**	**2022e**	**2023e**	**10Y interest rate**	**25-8-2022**	**+3M**	**2022e**	**2023e**
Federal Reserve	2.50 ↑	3.75 ↑	3.75 ↑	3.00	US Treasury	3.02 ↓	2.55 ↓	2.55 ↑	2.40
European Central Bank	0.00 ↑	1.00 ↑	1.00 ↑	1.00	German Bund	1.32 ↑	1.20 ↑	1.20 ↑	1.35
Bank of Japan	-0.10	-0.10	-0.10	-0.10	Japanese gov. bonds	0.23	0.20	0.20 ↓	0.20
Bank of England	1.75 ↑	3.00 ↑	3.00 ↑	2.50	UK gilts	2.62 ↑	2.90 ↑	2.90	2.00
People's Bank of China	3.65	3.60	3.60	3.60					
Natural resources	**25-8-2022**	**+3M**	**2022e**	**2023e**	**Currencies**	**25-8-2022**	**+3M**	**2022e**	**2023e**
Brent - Oil USD/barrel	101.2	120 ↓	120 ↑	120	EUR/USD	1.00 ↓	1.00 ↓	1.00	1.10
WTI - Oil USD/barrel	94.9	115 ↓	115 ↑	115	USD/JPY	136.5 ↑	130 ↑	130	120
Henry Hub - Gas USD/mmB	9.33 ↓	6.0 ↑	6.0 ↑	6.0	GBP/USD	1.18 ↓	1.18 ↓	1.18 ↓	1.25
TTF - Gas EUR/MWh*	263.7 ↑	90			EUR/GBP	0.84 ↓	0.85 ↓	0.85 ↑	0.88
Gold - USD/oz	1,751 ↓	1,700 ↓	1,700 ↓	1,900	USD/CNY	6.85 ↑	6.80 ↑	6.80 ↓	6.50

Source: Refinitiv, Bloomberg, ABN AMRO Group Economics

* Brent, WTI, Henry Hub: active month contract; TTF: next calender year

Changes from previous table 24 June

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