

Global Monthly

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Where is the recession?

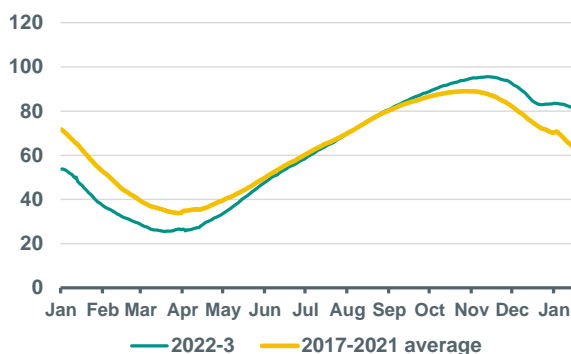
- ▶ Collapsing energy prices means the real income shock facing European consumers is likely to be less severe than previously thought, leading us to upgrade our eurozone and UK growth forecasts
- ▶ China's reopening is also a positive, though the flipside is that it may complicate the inflation fight
- ▶ Indeed, inflation remains the key challenge facing advanced economies, and the resulting tightness in monetary policy this year is a key reason why we still expect a recession in the eurozone and UK
- ▶ **Regional updates:** We describe our forecast changes in [the eurozone](#), while in [the Netherlands](#) we see upside risks to our Q4 GDP forecast on the back of more resilient consumption
- ▶ In [the UK](#), the less weak growth outlook is likely to mean rates stay higher for somewhat longer
- ▶ Dataflow in [the US](#) has been rather goldilocks-like, but the Fed is watching the labour market closely
- ▶ [China's](#) Zero Covid exit means an earlier start to the recovery, and a stronger growth outlook

Global View: The easing energy crisis is a major positive, but a shallow European recession is still likely

What a difference a month makes. When we published our Global Outlook on 9 December, wholesale energy prices were more than double current levels, which already were less than half the peak seen in August. As we argue in this month's *Global View*, the improved outlook for energy supply means we are unlikely to see prices return to levels seen last summer. While it will take time for lower prices to feed through to the economy, it has become increasingly clear that the shock to real incomes will now be less severe than we previously expected. As a result, we have significantly raised our GDP growth forecasts for the eurozone and UK economies. China's reopening is also likely to be supportive for global growth, though the flipside is that this could also put a dampener on the disinflation trend of the past few months. Indeed, despite the improved outlook, advanced economies still face a significant inflation problem, which means that monetary policy is likely to remain exceptionally tight this year, even as central banks begin (as we expect) to take their feet off the brakes later in the year. Given this, the expected rise in unemployment, combined with the fact that households are still adjusting to the existing real income shock, we do still expect a European recession this year – just one that is shallower than we previously expected.

Unseasonably high European gas inventories...

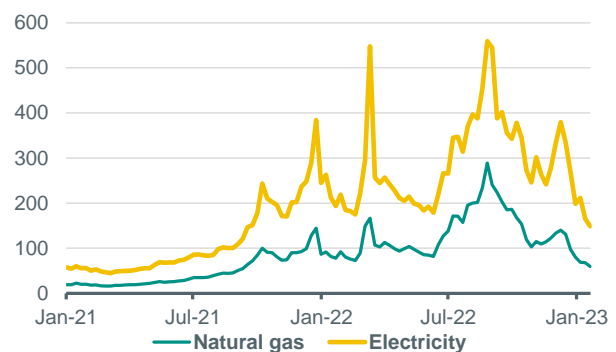
EU gas storage, % filled



Source: Bloomberg, ABN AMRO Group Economics

...have led to collapsing energy prices

€ per MWh (Netherlands)



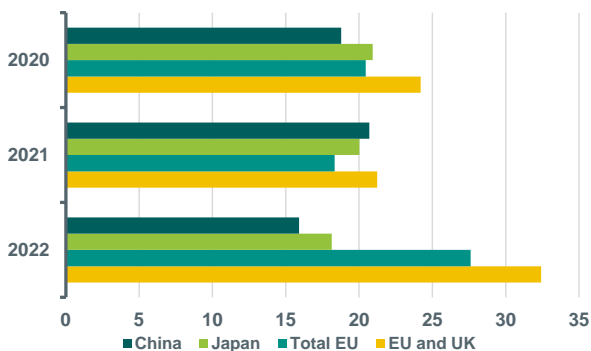
Source: Refinitiv, ABN AMRO Group Economics

The worst of the energy crisis looks to be behind us

Since our Global Outlook publication in December, the energy crisis has continued to ease dramatically. European gas inventories, filled to almost 80% at the time of writing, are well above the average of around 60% for this time of the year, and much higher than in the same period last year (45%). Significant declines in gas demand have persisted, for a large part due to the relatively mild winter, but record new renewables capacity additions, the restart of French nuclear power plants, and continued ample LNG flows have also helped. As such, even if the winter were to turn much more severe from here on, Europe is likely to be in a much stronger starting point for the next filling season than it was last year. While it is true that Europe will likely face more intense competition from China for global LNG supplies given the country's abrupt exit from Zero Covid, this will be offset by additional tailwinds in the broader energy space: 1) the ongoing French nuclear restart (which is not yet back at full capacity); 2) likely another record year for renewables capacity additions; 3) an expected rebound in hydro-electric output. Indeed, taking all of these factors together, Bloomberg NEF has estimated this will lead to a 28-48% reduction in European fossil fuel demand for power generation compared with 2022 consumption.

EU has benefitted from lower LNG demand from China

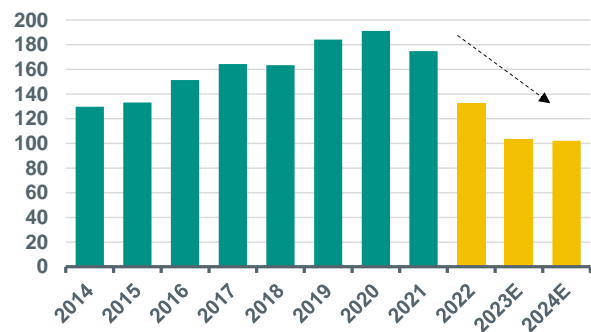
LNG consumption per region as % share of total



Source: Refinitiv, ABN AMRO Group Economics

But EU gas demand is likely to fall further in 2023...

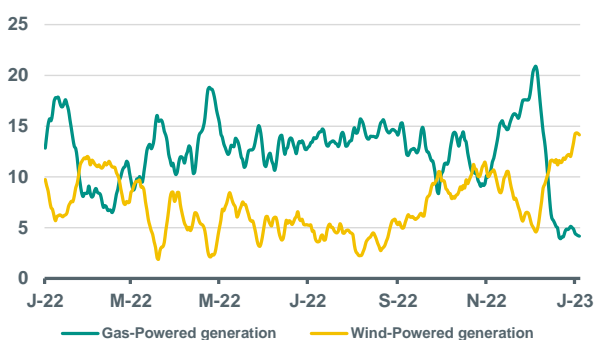
Annual power generation from gas in Europe, GWh



Source: Bloomberg NEF

...helped by record renewable capacity additions...

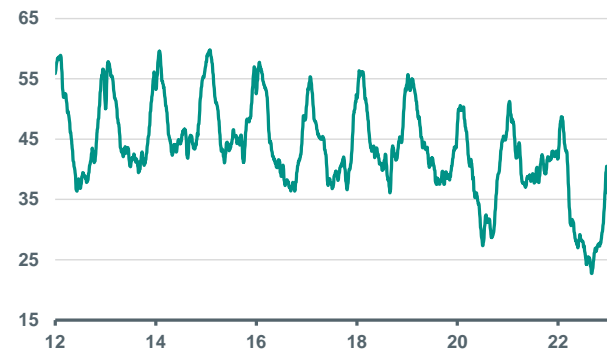
Daily MWh, thousands, 10dma (UK)



Source: Bloomberg, ABN AMRO Group Economics

...and French nuclear power plant restarts

Daily MWh, thousands, 10dma (France)



Source: Bloomberg, ABN AMRO Group Economics

The remarkable turnaround in Europe's energy supply outlook has naturally had a massive impact on wholesale energy markets. Gas prices have continued to plummet, and at around €60/MWh, the month ahead TTF price is now just 1/5 of the peak price of over €300 seen last August, and is trading at the lowest levels since the start of the energy crisis in September 2021. Electricity prices have naturally followed, also being now around 1/4 their August peak. While even these prices are much higher than peak prices in normal times (around €25-30/MWh for gas prices), it is a much more positive scenario than we expected even just a month ago.

Easing energy crisis means a more shallow European recession

Our new base case assumes that European energy prices will remain somewhat elevated compared to pre-crisis levels, but that we are unlikely to see the same magnitude of price spikes that we saw in 2022. This naturally implies a smaller shock to

household real incomes, and therefore a shallower recession than we previously expected. We have therefore significantly upgraded our 2023 growth forecasts for both the eurozone and UK economies, and we have also lowered our headline inflation forecasts. For the eurozone, we now expect 2023 average GDP growth of -0.3% compared with our previous forecast of -0.9%, while for the UK we have upgraded our forecast to -0.7% from -1.3% previously. The pass-through of lower energy prices to households and businesses is muddled by the patchwork of price capping regimes – which vary significantly per country – and energy prices themselves are still very much a moving target, making the effects difficult to estimate with precision. However, in the Netherlands for instance, already one utility provider has begun to offer energy contracts with prices below price cap levels set by the Dutch government, and assuming wholesale energy prices remain at current or lower levels, we are likely to see this repeated in other countries over the coming months.

Industrial catch-up on easing supply bottlenecks has also supported European growth...

Aside from the receding energy crisis, the easing of supply bottlenecks has supported activity to a greater extent than we thought. Naturally, energy intensive industry has seen some production losses from the crisis, but this has been offset in particular by a rebound in car production, as global chip shortages eased. Rebounding car production has led in turn to a rebound in car registrations, reflecting the significant backlog of orders when supply was constrained. This has supported private consumption to a greater extent than we thought in Q4, and has partly offset the weakness seen in other areas of consumption stemming from the real income shock. All told, the strength in Q4 data is a major contributor to our growth 2023 forecast upgrades in the eurozone and the UK.

Running down of backlogs has supported industry...

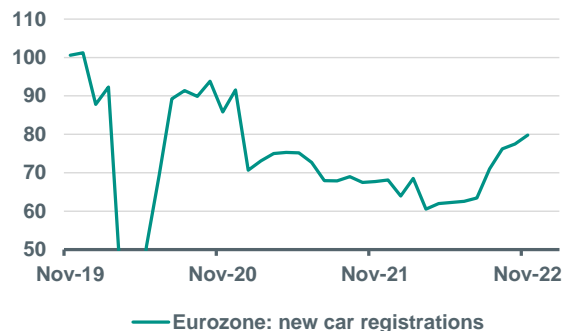
Index, pre-pandemic (Q4 2019) = 100



Source: Refinitiv, ABN AMRO Group Economics

...as well as consumption

Index, pre-pandemic (Q4 2019) = 100



Source: Refinitiv, ABN AMRO Group Economics

...but this won't last, and so we do still expect a shallow recession

These catch-up effects are likely to fade from here on. The rebound in production has led to a significant decline in order backlogs over the past few months, while final demand in the economy has been hit by the decline in real disposable incomes. This is likely to weigh on both industrial output and consumption going forward. At the same time, the lagged impact of monetary tightening is still feeding through to the economy. We are yet to see the full impact of existing rate rises, and we now expect the ECB's deposit rate to peak in May at 3%, meaning there is much still in the pipeline. While the recession is more shallow than we previously expected, we still also expect a rise in the unemployment rate. This, too, will have a knock-on dampening effect on consumption, as consumer precautionary saving begins to pick up again.

What impact will China's reopening have?

China's abrupt exit from Zero Covid is expected to cushion slowing demand in advanced economies, but we do not expect it to be a game changer. The eurozone's dependence on China consists mostly of industrial goods exports from Germany, which is linked to growth in China's manufacturing sector. However, even before China's Zero Covid exit, its manufacturing sector had already reopened for a large part, and this is reflected in the easing of supply side bottlenecks over the past year. At this point, then, China's 'reopening' is to a significant extent a domestic services story. Moreover, China's recovery is still constrained by weakness in the property sector and – related to that – weak credit growth, even if these headwinds are likely to fade as the year progresses. All told, while the reopening will boost China's GDP growth, we do not expect this to dramatically lift Europe's (or the US's) economic prospects. At least, not in the current environment where the weakness in

real incomes and tighter monetary policy are exerting a more powerful influence on the economy. Moreover, while China will provide some extra demand impulse for the global economy, the world's largest economy – the US – is still expected to slow significantly in 2023 (see US section). This slowdown will also to some extent offset any growth impulse from China.

Perhaps a more pronounced impact from China's reopening could come in the form of higher global inflation – or rather, less disinflation. In the short term, this could take the form of new supply side disruptions caused for instance by increased staff sickness; this would be temporary, however, and there is only patchy evidence of disruption of this sort so far, despite the seemingly rapid spread of the virus in recent weeks. A more lasting impact could come via rising commodity prices. Prospects for stronger Chinese domestic demand has already led to a rise in base metals prices that typically fluctuate with China's growth prospects, such as copper and iron ore. This represents a shift in the downtrend that had been in place for much of last year, although it remains to be seen if these moves will be sustained. On balance, we judge that China's reopening will be somewhat inflationary, but coming against the backdrop of softening demand in advanced economies and the broad easing in supply bottlenecks, we think this will be insufficient to shift the broad disinflation trend.

Supply bottlenecks have eased sharply

+ 6 = maximum bottlenecks / global imbalances supply-demand goods



Source: ABN AMRO Group Economics, Bloomberg, Refinitiv

China reopening could be somewhat inflationary

Iron ore (Feb63.5%) in CIF China, \$/MT/LME-Copper Grade A Cash, \$/MT



Source: Bloomberg, Refinitiv

Easing energy crisis is a boon for the economy, but challenges remain

The easing in Europe's energy crisis is an unquestionable positive for the outlook. While there is uncertainty over the timing of the pass-through of lower energy prices to consumers, real incomes are likely to start recovering sooner than we previously thought, and this has led us to significantly raise our eurozone and UK growth forecasts. China's reopening will also be somewhat supportive of global demand, although we must weigh this against the inflationary impact it may have.

Indeed, despite the significant falls in energy prices, the easing in supply bottlenecks and the cooling in demand, inflation continues to be the biggest challenge facing advanced economies at present. Inflation does look to have peaked; in the US it is already on a clear downtrend, and in Europe we expect inflation to trend lower in the course of the year. But there remain risks to the medium term inflation outlook – namely, the risk that higher wage inflation becomes entrenched, which could ultimately lead to inflation settling at a higher level in the medium term than central banks would like. This risk has reduced, but the easing of the energy crisis could be a double edged sword – while it is likely to lower inflation expectations and therefore reduce upward pressure on wages, the more shallow recession we expect will also mean less of a loosening in the tight labour market than we previously expected.

This highlights another, related risk to the outlook: that of a potential over-tightening by central banks. At present, central banks are understandably laser-focused on bringing inflation back to target. But in that determination, they may misjudge the risks and go too far. Implicitly in our forecasts, we expect this, as although we have further raised our forecast for ECB rate hikes – and now expect the deposit rate to peak at 3% – we also continue to expect central banks to correct course later this year once inflation risks have subsided, and to start cutting rates. For now we put our faith in central banks striking a reasonably good balance between inflation and recession risks, but there is a danger that policy stays too tight for too long, which could unnecessarily amplify or prolong the downturn. (Bill Diviney, Aggie van Huisseling, Jeannine van Reeken, Aline Schuiling, Arjen van Dijkhuizen)

Eurozone: Shallow, yet prolonged recession on the cards

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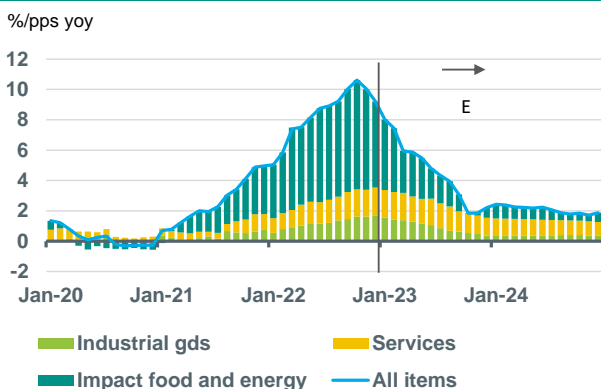
- ▶ **We have changed our base scenario for the eurozone economy and now expect a more shallow but more prolonged recession than we did before**
- ▶ **The ECB is expected to continue to hike rates, with the deposit rate peaking at 3%. Policy rate cuts could be on the agenda before the end of the year**

We have changed our base scenario for the eurozone economy. We have revised upward our forecasts for GDP growth in 2022Q4-2023Q1 and have lowered our forecasts for growth during the second half of 2023. There is a number of reasons for these adjustments. To begin with, the economic impact of the energy crisis has been more benign than we thought before. Indeed, there has been no rationing of gas supply to industry and global energy prices have dropped sharply in the past few months, which has also resulted in a drop in energy price inflation. Next, we had expected a rebound in industrial production in the second half of 2022 as supply conditions ease, but this rebound has been stronger than expected, particularly in motor vehicle production. This has also resulted in a sharp jump in new car registrations which will have lifted private consumption growth in 2022Q4 and 2023Q1. Finally, the impact of monetary policy tightening famously works with long and variable lags and we judge that most of the cumulative impact of past and upcoming rate hikes and tightening financial and bank lending conditions is still very much to be felt on the economy. As a result, we now forecast a more shallow, but more prolonged recession.

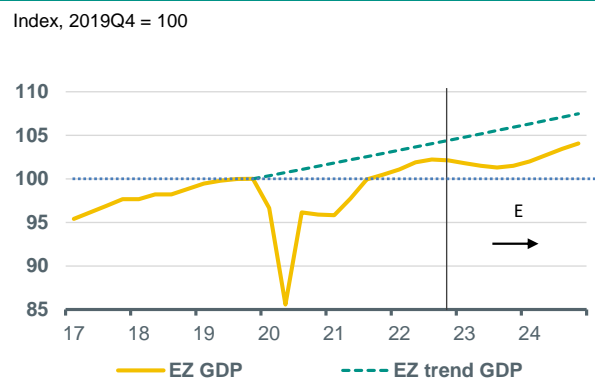
The tightness in the labour market could result in some labour hoarding, an acceleration in wage growth and a loss in labour productivity during the early phase of the recession. We expect the unemployment rate to start rising gradually from the second quarter of 2023 onwards and for wage pressures to ease in the second half of this year and in 2024.

We have lowered our forecast for headline inflation in 2023 to 4.5% from 5.1% and we expect inflation to fall in line with the ECB's 2% target by the end of this year. Core inflation (excluding food and energy) is expected to be more sticky and decline more gradually. As a result, core inflation should be higher than the headline rate in the final months of this year. We see core inflation falling gradually towards 2% in the second half of 2024.

EZ inflation and contribution of main components



EZ economy in a shallow but prolonged recession



Given the more resilient recent macro data, we expect the ECB to continue raising its policy rates until May, with a peak of 3% for the deposit rate (from 2.75% previously). Our new forecast is based on a 50bp rise next month, followed by two 25bp steps in the two subsequent meetings (though a solitary 50bp step in March is clearly also a possibility). We think that policy rate cuts will be on the agenda before the end of the year. Rate reductions would start the process of normalising policy back to more neutral settings in 2024.

The Netherlands: Resilient consumers may surprise Q4 print

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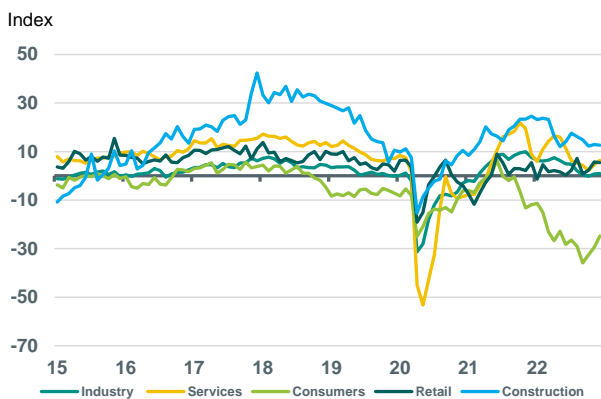
- ▶ **GDP expected to contract in Q4 2022 and Q1 2023, with growth to resume in second half 2023**
- ▶ **The underlying trend in the broadening of inflation will continue well into 2023...**
- ▶ **...but we expect headline inflation to decrease to an average of 4.3% in 2023**

Similar to the eurozone, the Dutch economy is showing resilience in the face of the energy crisis and high inflation. A better performance of the eurozone bodes well for Dutch external demand, while sturdy domestic consumer spending poses upward risks to our expectation of small contractions in Q4 2022 and Q1 2023. Even so, growth is still likely to be lacklustre in the first half of this year. We expect inflationary pressures to ease in the course of 2023. Government support and spending, as well as elevated wage growth, will lead to growth resuming in the second half of 2023.

Official consumption figures, available until November, show resilience despite inflation being still in double digits. There are however large sectoral differences. Overall, consumption is being supported by the catch-up in services, but goods consumption has been negative in annual terms since May 2022. As more households are exposed to inflation, through both higher energy prices and the broadening of inflationary pressures, we expect consumption to contract in the coming months.

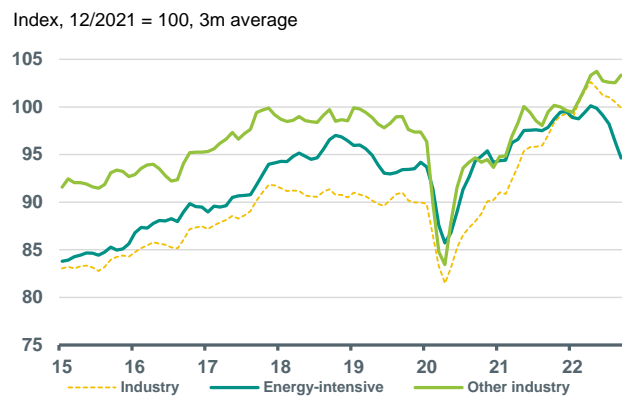
On the back of rising interest rates and tighter monetary policy, the Dutch housing market has turned a corner. Whereas house prices rises in recent years have supported consumption via the wealth-channel effect, the turning of the tide in house prices means this support is falling away. We expect this negative effect to become larger in the course of 2023, forming another drag on consumption. An even larger, short-term effect on GDP from lower house prices comes from declines in housing investment. In similar fashion, overall investment is set for a weak year, being hampered by elevated uncertainty, weak prospects for demand and higher interest rates.

Confidence indicators reflect uptick in sentiment



Source: CBS, ABN AMRO Group Economics

Energy-intensive industry still struggling



Source: CBS, ABN AMRO Group Economics

The effects of higher energy prices on the supply side have been less pronounced than anticipated. Still, this does not mean there is no scarring from record rises in energy prices at all. Total industrial production, albeit declining in recent months, remains quite robust. However, when decomposing industrial production, we see output in energy-intensive industrial subsectors falling significantly further.

Inflation has been declining for three consecutive months since the September peak of 17.1% yoy, to 11% in December. The recent declines are primarily energy related. We expect energy prices to contribute negatively to inflation in 2023, as wholesale energy prices have seen large drops recently and the price ceiling will cap household energy bills from January onwards. The underlying trend of broadening inflation in goods, services and food is continuing. Our view is that this trend will continue until well into 2023. This view is supported by our research on energy spending done by SMEs. We see that still a significant share of firms is not yet faced with higher energy prices due to fixed contracts. With these contracts ending, more firms will be exposed to higher energy prices and be forced to pass these on to customers (read more [here](#)). With average HICP inflation in 2022 coming out at 11.6% we expect inflation to decrease to an average of 4.3% in 2023.

US: Goldilocks, is that really you?

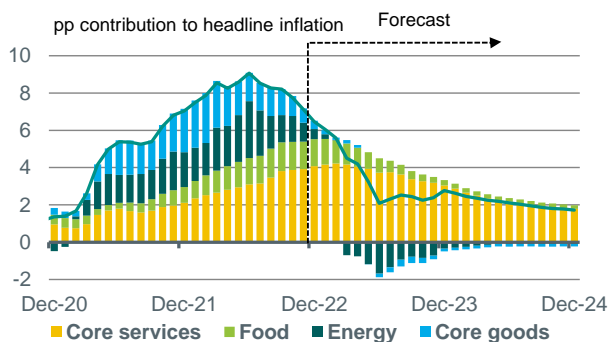
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- ▶ **Sharply falling inflation coincided with surprisingly strong growth in Q4. This triggered comparisons to the pre-pandemic ‘goldilocks’ period, when the tight labour market was non-inflationary**
- ▶ **While a benign, soft landing scenario has become more likely, we still think the Fed will want to see a significant weakening in the labour market before it is confident the inflation battle is won**
- ▶ **Weak activity data towards the end of Q4 suggests we are on the cusp of such a weakening, and this will support our expectation for significant Fed rate cuts later in the year**

Since our [Outlook](#) last month, inflation has continued its long trend downward; as of December, both headline and core measures are well off their June peaks, and are now the lowest they have been in a year. While uncertainty remains over where inflation ultimately lands, we are confident the trend will be downward over the coming months. The drivers of falling inflation are still very much in play: 1) cooling domestic demand, 2) the recovering supply side, 3) the easing in global pipeline pressures. With that said, risks to the outlook are still significant. Labour hoarding has meant that the slowing in jobs growth, and the decline in vacancies, has been more sluggish than we expected. In recent months, the still-tight labour market has led to remarkably little wage inflation, and the most recent wage growth readings have been consistent with the pre-pandemic trend. Still, the Fed will not take its chances, and the Committee will need to see a rise in unemployment and a significant fall in job vacancies before it is confident the inflation battle is won. Goldilocks is unlikely to stick around.

Inflation has continued on its long trend downward

% yoy



Source: Refinitiv, ABN AMRO Group Economics

Wage growth has cooled, but will it stay that way?

Average hourly earnings, % 3m/3m saar



Source: Refinitiv, ABN AMRO Group Economics

As if to underline this, the otherwise strong Q4 ended on a very weak note. December retail sales and industrial production fell by -1.1% m/m and -0.7% respectively, with November data also downwardly revised. The decline in retail sales was broad-based. This followed a very strong October, meaning private consumption is still likely to have made a solid gain in Q4 when GDP data are released this week. Industrial production in contrast declined over the quarter, driving capacity utilisation to its lowest level in a year, at 78.8%. This increase in spare capacity appears to be constraining producer pricing power, which helps explain the drop in producer prices. The hard data now appear to be moving more in line with what the PMIs had signalled for some months, and this suggests that following the bounce in GDP in Q4, we are likely to see a decline in output in Q1, which would be in line with our base case. For Q4, however, we now expect growth of around 2.5% annualised, up significantly from our initial expectation of 1%. As a result, we have raised our 2022 GDP forecast marginally by 0.1pp to 2.0%, but there is also carry-over to 2023, with our forecast up by 0.2pp, to 0.7%.

The broad softening in activity, alongside the easing in inflationary pressure, supports our view that the Fed is approaching the end of its rate hike cycle, and that it is likely to start cutting rates by this coming September. We continue to expect a total of 125bp in rate cuts later this year, with falling inflation and weak activity the likely trigger for a reduction in policy restriction. This would take the fed funds rate down from the expected peak of 4.75-5.00% to 3.50-3.75% by year end. The key risk to this view is the sluggish pace of the labour market cooling, due to labour hoarding. We view this behaviour as unsustainable in the face of softening demand, and we continue to expect the unemployment rate to begin rising as the year progresses. But more persistent labour market strength could mean policy stays somewhat tighter for longer.

UK: Rates to stay higher for longer, despite falling energy prices

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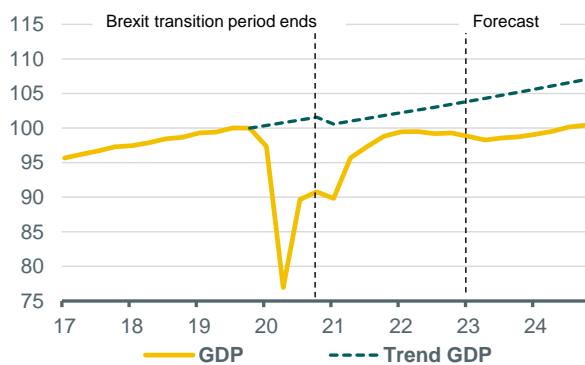
- ▶ **Reduced shock to real incomes has led us to significantly raise our 2023-4 growth forecasts**
- ▶ **Still, the economy remains weak, and faces major fiscal and monetary headwinds**
- ▶ **The Bank of England is likely to significantly raise its growth projections on the easing energy crisis, and we now think interest rates will stay on the high side for somewhat longer**

The collapse in energy prices of recent weeks has led to a remarkable improvement in the outlook. As we describe in this month's Global View, while energy prices are expected to remain above pre-crisis norms, the falls in prices are likely to lead to an earlier recovery in real incomes than we previously expected. As such, we now expect the recession to be concentrated in the first half of 2023, with a gradual recovery expected in H2, as lower energy tariffs start to feed through to household energy bills. Still, the recovery is expected to be a sluggish one to begin with, given the many headwinds facing the economy. As we described in more detail in our [Outlook 2023](#), the tax burden is set to rise significantly from April onwards, and much of the impact of interest rate rises is still to come. All told, we now expect a contraction of -0.8% in 2023 (-1.3% previously), and a somewhat stronger recovery in 2024 of 1.2% (up from 1.0% previously).

Indeed, the easing energy crisis could be a double edged sword for monetary policy – a shallower recession is likely to mean less of a rise in the unemployment rate. While inflation expectations should come down on the back of lower energy prices, this will be offset by stronger worker bargaining power given what is likely to still be a tight labour market. It remains to be seen how these forces net out, but on balance, we think somewhat higher wage growth means the Bank of England is now likely to cut rates at a slower pace than we previously thought. Bank Rate is still expected to end 2023 at 3.5%, from an expected 4% peak in March, but we expect rates to fall more gradually in 2024, to 2.75% (up from 2% previously).

A shallower recession, but the outlook is still weak

GDP; Index, Q4 19=100



Source: CBS, ABN AMRO Group Economics

Rates are now likely to stay higher somewhat longer

Bank Rate, %; yellow = our forecast



Source: CBS, ABN AMRO Group Economics

Alongside an expected 25bp rise in Bank Rate, the MPC will publish its latest economic forecasts on 2 February. We expect it to raise its GDP growth forecast, lower its inflation forecast and signal a somewhat more hawkish policy stance. Much has changed since the last forecast update in November, when the BoE projected a two-year long recession. Externally, eurozone growth prospects have improved because of lower gas prices and the resurgence in car production. We have also upgraded our forecasts for China and the US. Domestically, wholesale gas prices have fallen sharply, and these lower prices will feed-through to final users over the course of the year, supporting business activity and household incomes (we expect Ofgem to lower the market-based price cap in July). Another UK-specific development since the November Monetary Policy Report is the restoration of calm and stability in the political and policy landscape (see our Outlook for more).

Set against this is the ongoing dispute between the government and public sector workers which has resulted in numerous strikes across the transport, health and education sectors. The direct impact of the strikes on the economy is [judged to be relatively small](#), with the main risk to inflation and monetary policy from higher wage settlements. A negotiated settlement will most likely result in higher public sector pay with upside risks for inflation and interest rates.

China: Goodbye Zero-Covid, Welcome Recovery

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- ▶ **Rapid Zero-Covid exit means China's rebound will start earlier and will be a bit more pronounced**
- ▶ **Following a turbulent exit, we expect a staged recovery in domestic demand and economic growth**
- ▶ **We raise our 2023 growth forecast to 5.2%, from 4.8%, with downside and upside risks remaining**

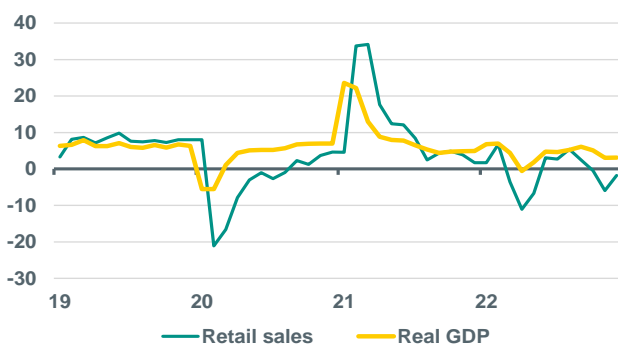
In our [2023 China Outlook](#) published in early December, we noted that headwinds should partly fade this year thanks to the Zero-Covid exit and more property sector support. With the rapid turn in Covid-19 policy since, and other signs that supporting economic growth has moved up Beijing's priority list, we assume that the phased rebound of domestic demand – following a messy exit in late 2022 and early 2023 due to public health issues – will start earlier and will be a bit more pronounced, with above-trend quarterly growth in Q2 and Q3. As a result, we have raised our annual growth forecast for 2023 to 5.2%, from 4.8%. That said, the road to recovery could well prove bumpy, with several headwinds (such as slowing external demand and tensions with the US/west on tech/Taiwan), and downside but also upside risks remaining.

Following the turbulence stemming from the abrupt Zero-Covid exit and related public health issues ...

Following unprecedented protests in November, the government made a U-turn in Covid-19 policy (both at the central and local levels), from the unique strict Zero-Covid stance to a *laissez-faire* policy. This implies a clear decrease in the overall lockdown intensity, going hand in hand with a surge in infections and casualties. Official numbers do not give a reliable picture of the real damage to public health, but reports of overburdened hospitals and crematoria speak for themselves. Although we have already seen an improvement in some mobility data in early 2023 (particularly car traffic, as travellers are still a bit cautious regarding public transport), the U-turn in Covid-19 policy does not mean an immediate sharp turnaround in momentum on all fronts. This is also illustrated by recent data. December activity data pointed to a further slowdown, although retail sales were surprisingly strong, driven by car sales (with a tax breaking expiring end-2022) and medicine. After the Q3 22 rebound from the broad lockdown slump in the spring, real GDP slowed again in Q4, although coming in better (at 0.0% qoq and 2.9% yoy) than expected. Covid-19 cases could surge again in and just after the Lunar New Year holiday period end-January, when many Chinese visit their home towns. This could create renewed disturbances to both the supply and demand side, although so far production chains seem to have held up quite well despite the messy Zero-Covid-exit.

As consumption has lagged, there's room for catch-up

% yoy (real GDP: monthly estimate Bloomberg)



Source: Bloomberg, Refinitiv, ABN AMRO Group Economics

Household savings have risen in the Zero-Covid era

Household deposits held at Chinese financial institutions, CNY bn



Source: Refinitiv

... we expect a staged recovery in domestic demand, and GDP growth to gain momentum

Not all headwinds will suddenly disappear due to the U-turn in Covid policy, with export strength fading on weaker global demand, the property sector not out of the woods yet and credit growth on a weak footing. Still, we think the rapid exit from Zero-Covid takes away one of the most prominent drags, also given the effects it had on consumer confidence and the property slump. Coupled with the stepping up of targeted support, and with more signs of progress made with resuming stalled construction projects, we anticipate the property sector to bottom out, although restoring confidence remains key and will take time. We assume these policy shifts will also help turning the credit cycle, as weak mortgage demand has been key in explaining recent weakness in credit growth. All in all, we expect the drawdown of excess savings and improving consumer confidence to help spur a phased pick-up of consumption, with above-trend qoq growth of real GDP in Q2/Q3.

Key views on a page

The easing energy crisis in Europe is leading to more shallow expected recessions in the eurozone and UK, while the US is also entering a moderate downturn. In the near term, consumption will continue to be weighed by falling real incomes, housing markets are correcting on the back of the surge in mortgage rates, and industry is being hampered by still-high energy prices. China's abrupt exit from Zero Covid is a modest growth support, but also somewhat inflationary. While inflation has begun to trend lower, upside risks to the medium term inflation outlook mean the Fed, ECB and BoE are likely to continue raising rates at coming meetings. By late 2023, falling inflation and economic weakness are likely to drive rate cuts, but the recovery is expected to be tepid.

Macro	Central Banks & Markets
<p>Eurozone – The economic impact of the energy crisis has been more benign than we thought before. However, most of the impact of past and upcoming rate hikes and tightening financial and bank lending conditions is still very much to be felt on the economy. We forecast a shallow, yet prolonged recession, with GDP contracting modestly during four consecutive quarters, starting in 2022Q4. Headline inflation should drop lower due to falling energy price inflation. It could be around the ECB's 2% target by the end of this year. Core inflation is expected to be more sticky and be higher than the headline rate by the end of 2023.</p>	<p>ECB – The ECB slowed down the pace of rate hikes to 50bp in December. Nevertheless, the message of the policy meeting was decidedly hawkish, with the central bank saying that 'interest rates will still have to rise significantly at a steady pace'. The ECB also announced a tapering of reinvestments for the APP portfolio. The decline will amount to EUR 15 billion per month between March and the end of Q2 2023. The subsequent pace still has to be decided. We expect the ECB to continue to hike rates, with the deposit rate peaking at 3% by May. Policy rate cuts could be on the agenda before the end of the year.</p>
<p>Netherlands – GDP expected to contract in Q4-2022 and Q1-2023, but upward risks are posed by sturdy consumer spending and a better performance of the eurozone which bodes well for Dutch external demand. Still, growth is expected to remain lacklustre in the first half of this year, but to resume in the second half of 2023. While the recent declines in inflation are primarily energy related, the underlying trend in the broadening of inflation will continue well into 2023. However, we expect headline inflation to decrease to an average of 4.3% in 2023.</p>	<p>Fed – We expect the Fed to downshift to 25bp hikes at the February and March meetings, with the upper bound of the fed funds rate to peak at 5%. Subsequently, we expect the Fed to pause, assuming inflation continues moving lower and the labour market deteriorates. The risk to near-term rates is still to the upside. A higher near-term policy rate means a higher risk of over-tightening, and we expect significant rate cuts in late 2023. In the background, the Fed continues to unwind its balance sheet at a \$95bn monthly pace.</p>
<p>UK – While the easing energy crisis will soften the blow to household real incomes, the tax burden is set to rise significantly over the coming year. Demand is already weak on the back of record low consumer confidence, and tightening fiscal policy will compound the impact of monetary tightening. We expect more shallow recession, on falling energy prices, and despite weak demand, there is a continued risk of a wage-price spiral due to a structural shortage of workers, and public sector unrest.</p>	<p>Bank of England – The continued risk of a wage-price spiral in the UK led the MPC to hike rates by a further 50bp at the December meeting. We now expect a 25bp hikes in February and March, with Bank Rate to peak at 4%. Fiscal policy U-turns have significantly reduced the risk of more aggressive rate hikes, and market pricing for Bank Rate is now much closer to our own expectations. We expect the BoE to reverse course in late 2023 and start cutting rates, but at a slower pace than we previously expected.</p>
<p>US – The US consumer exhibited surprising resilience for much of 2022, but the twin headwinds of falling real incomes and dwindling excess savings are now exerting a bigger drag on consumption. Investment is also expected to remain weak in the near term. This will help inflation along its downward-sloping trend, while labour hoarding is likely to give way to a rise in the unemployment rate. This will lead to the NBER likely declaring a recession this year. Inflation is expected to fall significantly in 2023 on the back of sharply easing pipeline pressures, and be within touching distance of 2% by the end of the year.</p>	<p>Bond yields – Given our economic and central banks' outlook, we think both the 10y US and Bund yields have peaked. The recession will weigh on EU rates in 2023 with the 10y Bund yield expected to fall below the 2% level in 2023. A similar path is expected for US rates. Both Treasury and Bund curves are expected to remain inverted through most of 2023 as elevated core inflation will maintain short-term rates higher for longer. Thereafter, we expect both curves to bull-steepen in the second part of the year on the back of monetary easing, with 125bp and 50bp in rate cuts pencilled in for the Fed and ECB rates respectively.</p>
<p>China – Given the rapid exit from Zero-Covid, and with other signs that supporting growth has moved up Beijing's priority list, we assume that the phased rebound of domestic demand – following a messy exit in late 2022 and early 2023 due to public health issues – will start earlier and will be a bit more pronounced, with above-trend qoq growth in Q2 and Q3. As a result, we have raised our annual growth forecast for 2023 to 5.2%, from 4.8%. Still, the road to recovery could well prove bumpy, with several headwinds and downside but also upside risks remaining.</p>	<p>FX – We think there is more upside in EUR/USD than we had forecast for 2023 and 2024. We expect the Fed to take the upper bound of the fed funds rate to 5%. However, we still expect significant rate cuts in H2 23 and far more than market consensus (a total of 125bp compared to 50bp of cuts). This is negative for the US dollar. Meanwhile we have become less negative on the growth outlook for the eurozone. As a result of these dynamics we have upgraded our EUR/USD to 1.12 (from 1.08) end of 2023 and to 1.16 (from 1.12) end of 2024.</p>

Main economic/financial forecasts

GDP growth (% yoy)	2021	2022e	2023e	2024e	Inflation (%)	2021	2022e	2023e	2024e
United States	5.9	2.0	↑ 0.7	2.0	United States	4.7	8.0	↓ 3.4	↓ 2.1
Eurozone	5.3	3.4	↑ -0.3	↓ 0.9	Eurozone	2.6	8.4	↓ 4.6	↓ 2.1
Japan	2.2	1.2	↓ 1.4	↓ 1.2	Japan	-0.2	2.5	↑ 2.0	1.0
United Kingdom	7.6	4.1	↑ -0.8	↑ 1.2	United Kingdom	2.6	9.1	↓ 6.4	↓ 2.0
China	8.4	3.0	↑ 5.2	5.2	China	0.9	2.0	2.5	2.5
Netherlands	4.9	4.2	↓ 0.5	↑ 1.2	Netherlands	2.8	11.6	4.3	4.0
Policy rate	20/01/2023	+3M	2023e	2024e	10Y interest rate	20/01/2023	+3M	2023e	2024e
Federal Reserve	4.50	5.00	↑ 3.75	2.50	US Treasury	3.48	3.30	3.00	2.75
European Central Bank	2.00	2.75	↑ 2.50	1.50	German Bund	2.17	1.80	↑ 1.55	1.65
Bank of Japan	-0.10	-0.10	0.00	0.00	Japanese gov. bonds	0.25	0.50	↑ 0.50	0.50
Bank of England	3.50	4.00	3.50	↑ 2.75	UK gilts	3.38	3.25	2.60	2.20
People's Bank of China	3.65	3.60	3.60	3.60					
Natural resources	20/01/2023	+3M	2023e	2024e	Currencies	20/01/2023	+3M	2023e	2024e
Brent - Oil USD/barrel	86.2	120	110	100	EUR/USD	1.08	1.07	↑ 1.12	↑ 1.16
WTI - Oil USD/barrel	80.3	115	105	95	USD/JPY	129.6	132	↓ 128	↓ 124
Henry Hub - Gas USD/mmBtu	3.28	6.0	6.5	5.0	GBP/USD	1.24	1.22	↑ 1.25	↑ 1.28
TTF - Gas EUR/MWh*	64.7	65	↓ 75	↓ 65	EUR/GBP	0.88	0.88	↓ 0.90	↑ 0.91
Gold - USD/oz	1,932	1,700	1,900	1,900	USD/CNY	6.79	6.80	6.70	6.50

Source: Refinitiv, Bloomberg, ABN AMRO Group Economics

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

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