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Global Monthly

Macro Research Team abn.amro.group.economics@nl.abnamro.com Bill Diviney: +31-6-4778-4657

What if policymakers get the energy crisis wrong?

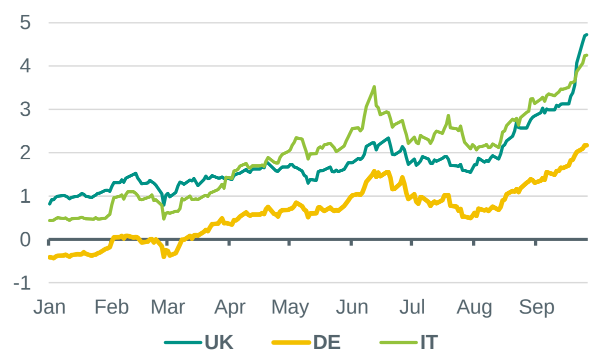
- **European markets, economies and governments are adapting rapidly to energy shortages**
- **Gas consumption has fallen significantly, with rationing over the winter now likely to be avoided**
- **However, there is now a risk that governments might go too far in their attempts to avert recession**
- **Regional updates: The *eurozone* looks to be rapidly slowing, consistent with our recession expectation. In *the Netherlands*, new government measures are softening the energy crisis blow**
- **Economically damaging rate hikes might be the only solution to *the UK*'s confidence crisis**
- ***The US* economy appears to be landing softly so far, but the Fed's job is still not done**
- **Recent strong data are a positive sign from *China*, but significant headwinds remain**

Global View: The UK's confidence crisis highlights the risk of policymaking going awry

Since our last *Global Monthly*, the European energy crisis has entered a new phase, as markets, economies and governments have adapted to the new reality of energy shortages. The good news is that European gas inventories have continued to rise ahead of the heating season, prices have fallen significantly from the astronomical highs reached in August, and gas consumption among both households and businesses looks as though it is seeing a necessary and sustained fall. However, the risks remain significant, and increasingly, the policy response is coming under scrutiny as governments attempt to offset the pain of the energy crisis. The most spectacular example of this was the UK's not-so-mini budget announcement last Friday, which contained a generous household and business energy price cap, and the biggest tax cuts since the 1970s – all entirely unfunded, and therefore implying a massive rise in the deficit next year. Ultimately, the central bank will be forced to offset most of the growth-supportive impact of these plans given the pressure the currency has come under, as well as the risks the policy poses to the medium-term inflation outlook. While aggressive fiscal policy moves on the scale of the UK's are unlikely elsewhere in Europe, the market reaction served to highlight the risk governments run if they go too far with their interventions. Business and consumer confidence surveys over the past month suggest the eurozone and UK economies are probably already in a recession. While carefully calibrated policy measures might help to ease some of the pain of recession, they will not help economies escape the reality of supply constraints that they face.

UK government bond yields have surged above Italy's

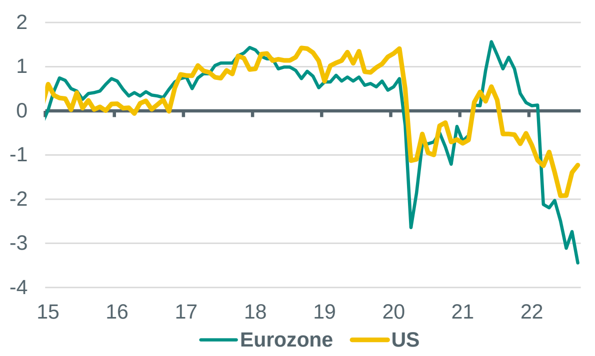
5 year government bond yield, %



Source: Bloomberg, ABN AMRO Group Economics

Eurozone consumer confidence has plummeted

Consumer confidence indices, standardised

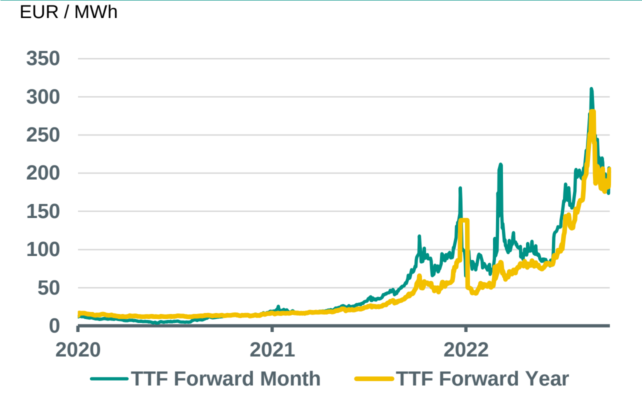


Source: Bloomberg, ABN AMRO Group Economics

Energy prices have come off the astronomical highs set in August

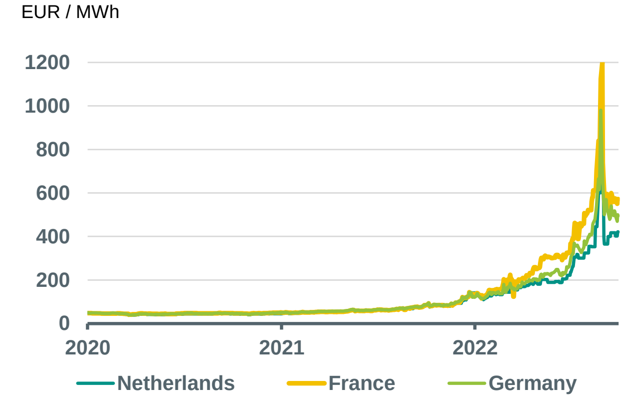
Gas prices have fallen to almost half the peak level reached in August, as the signing of long-term LNG contracts, the opening of new floating regasification capacity at Eemshaven in the Netherlands, alongside the aforementioned ample inventories heading into winter led to a reduction in speculative long positioning in the gas market. Still, there remains significant uncertainty. While a mild or an average winter would mean Europe probably scrapes by without physical shortages, much depends on how demand evolves, and also how fierce competition from Asia will be for spot LNG cargoes. This will also depend on how severe the Asian winter is. In the event of a severe winter in either Europe or Asia, physical gas shortages could yet trigger another price surge back to the record highs we saw in August. The apparently deliberate sabotage of the Nord Stream pipeline – which triggered a rebound in gas prices in recent days – highlights also the risk of unforeseen events for prices.

Gas prices have fallen by almost half from their peak…



Source: Bloomberg, ABN AMRO Group Economics

…helping to drive electricity prices back lower



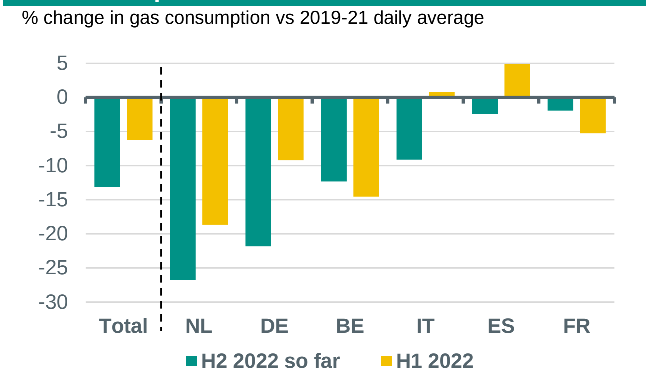
Source: Refinitiv, ABN AMRO Group Economics

Lower overall gas prices, as well as improved conditions for other power generation sources such as coal and nuclear, have also fed through to lower electricity prices. A number of French nuclear power plants are expected to come back online towards the end of the year, while a rise in Rhine river levels has made the transport of coal easier again in Germany. With that said, with progress stalling on EU attempts to de-link electricity prices from the gas price, for the time being electricity prices continue to be largely determined by gas market conditions.

Falling gas consumption suggests physical shortages might be avoided

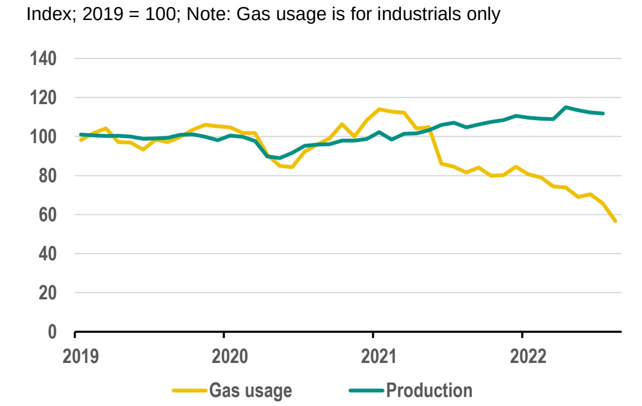
Further good news is apparent in the gas consumption data – something we are now tracking closely. Year-to-date, average daily gas consumption is now down by 8.5% across the 'big six' eurozone countries (the Germany, France, Italy, Spain, the Netherlands, Belgium). That fall has picked up pace particularly over the past few months as prices have surged further, with the daily average down 13.2% since July – approaching the EU target of a 15% cut in demand. At the same time, and as we have highlighted before for the Netherlands specifically, production has largely held up despite the declines in gas usage.

Gas consumption has fallen…



Source: Refinitiv, ABN AMRO Group Economics

…while production has largely held up, so far



Source: Refinitiv, ABN AMRO Group Economics

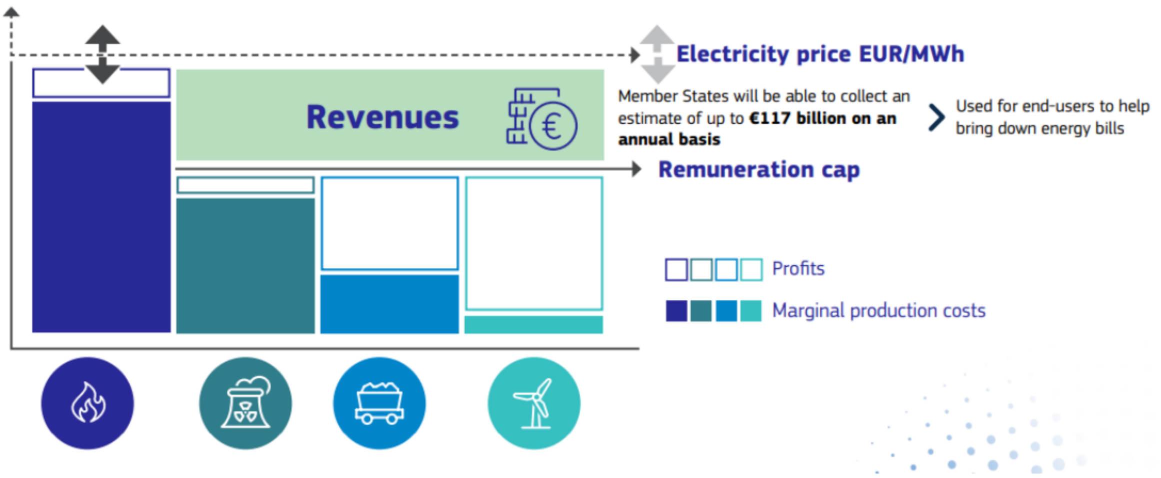
The drivers of the declines have varied. For households, homes are being better insulated and people are cutting back on cooling and heating in response to high prices. In industry, oil refineries for instance have made the relatively easy switch to using oil rather than gas as an energy source. In some other cases, producers have been able to idle capacity temporarily in the hope that prices would decline again at some point, relying on existing inventories of certain inputs in the meantime. In the cases where viable substitutes exist for gas, or where households or services providers are able to reduce consumption due to greater energy efficiency or acceptance of lower heating temperatures, the impact on output would remain minimal. However, for some producers the current consumption declines will be difficult to sustain without production cutbacks. This is one of the reasons we still expect the energy crisis to lead to declines in GDP over the coming quarters, and the weakness in a range of manufacturing indicators (notably the PMIs) recently is consistent with our expectation.

But government intervention runs the risk of clouding the incentives to lower gas use…

At the same time, the large declines in aggregate consumption hide significant variations between countries. In particular, the declines have been much larger in Germany and the Netherlands – where so far there has been relatively little intervention by governments to cap prices – than in France and Spain, where governments moved quickly to cap prices. As governments increasingly move in the direction of price caps, the data therefore highlight the danger that price caps might significantly reduce the incentive to cut back on energy use, which is ultimately necessary if Europe is to avoid a physical shortage of energy.

…as policy becomes increasingly supportive of demand

Indeed, the big story in recent weeks has been the increasingly muscular fiscal response to recession risks in Europe. Two major developments have been the announcements of household energy price caps by the Dutch and UK governments. In both cases, the caps are very generous and very expensive, but they differ in their impact on incentives to reduce energy use, as well as how they are funded. The latter is important not only from a debt sustainability standpoint, but also in terms of the net fiscal impulse to the economy and therefore its impact on the medium term inflation outlook. The cap in the Netherlands covers households and small businesses, but only up to a certain level of usage – above which market prices apply. In addition, although the cost of the plan is uncertain, a significant proportion is paid for by the rollback of an energy tax reduction that has applied until now, as well as a windfall tax on power suppliers that are not dependent on expensive natural gas (see figure below).



Source: European Commission

In the UK, in contrast, the cap applies regardless of usage, meaning that the incentive to reduce consumption is significantly blunted (there remains some incentive given that prices will still be much higher than before the crisis), while there is a separate cap in place for both SMEs and large corporate energy users (the Dutch cap only applies to SMEs). The other difference with the Netherlands is that other support measures will remain in place, and the government has ruled out imposing a windfall tax on non-gas electricity providers (an existing tax on the domestic oil and gas sector will remain). As such, the much higher cost of the UK plan, combined with the fact that it is entirely funded by debt means that it is a significantly bigger net fiscal impulse to demand in the economy.

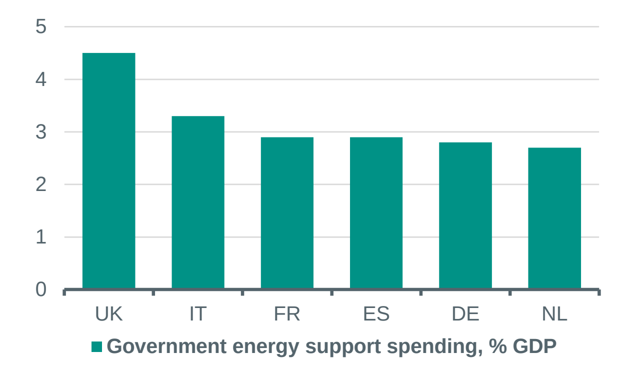
These policy announcements are just the latest in a raft of interventions by European governments over the past year, which we summarise by country in the table below.

	Household price cap	Cash transfers to households	Wholesale price cap	Business price cap	Other business support	Windfall tax
Germany	Partial					
France			Partial	Partial		
Italy						
Spain				Indirect		
Netherlands	Partial			Partial		
UK						

Source: ABN AMRO Group Economics; green = policy decided/implemented; yellow = policy still being formulated

Policies have ranged from direct cash transfers to the most vulnerable households, to sweeping price regulation mechanisms. And there is still more to come: Germany is currently working on its own household energy price cap which, like that of the Netherlands looks likely to come with a usage limit, and will be partly funded by an energy windfall tax. At the EU level, meanwhile, work continues on the development of a wholesale gas cap, and a cap on electricity not generated by gas. In Italy, while the government has already made significant interventions over the past year, its newly-elected government could also come with additional measures over the coming months.

Governments spending aggressively to offset the crisis



Source: Bruegel, ABN AMRO Group Economics

Three risks from doing too much

While it is understandable that policymakers are acting to shield households and businesses from the worst effects of the energy crisis, we highlight three reasons for caution. First, there is the danger that price caps reduce the incentive to lower consumption, which is necessary given the very real risk Europe faces of energy shortages during the winter months. In that regard, price caps that apply up to a certain threshold of energy use – as we see in the Netherlands – look better placed to achieve that goal. Second, in an environment of significantly constrained supply and high inflation, providing blanket stimulus to the economy is like adding fuel to a fire. As such, any gain from growth will be short-lived and counter-productive, because central banks will have to act more forcefully to counter the effects – as we are now likely to see in the UK (and with deeply damaging implications for the economy). It is notable, in this respect, that ECB President Lagarde warned against generalised fiscal stimulus in her remarks this week to the European Parliament. Thirdly, with interest rates surging, governments no longer have the same room to rapidly expand deficits without triggering negative reactions from the investors that are being asked to finance those deficits, as again the example of the UK has shown over the past week. This raises risks to financial stability that in turn can further weaken the growth outlook.

In short, governments face a very different environment to the one they faced in the early stages of the pandemic, when inflation and interest rates were at historic lows, and there was little prospect of a shortage of anything in the economy. Responding in the same way as during the pandemic could therefore backfire.

A recession in Europe still looks unavoidable

Given the above constraints, we continue to expect a recession in European economies over the coming year. Europe looks likely to get through the coming winter without physical shortages of energy, but this will still come at a cost – both in the form of falls in people’s real incomes, and losses in production as manufacturing capacity is idled. In cases where governments do attempt to fully ease the pain with fiscal measures, this is likely ultimately to be offset by steeper rises in interest rates by central banks – as well as raising the risk once again that energy shortages become realised. (Bill Diviney, Hans van Cleef, Sandra Phlippen, Aggie van Huisseling)

Eurozone: ECB speeds up policy normalisation

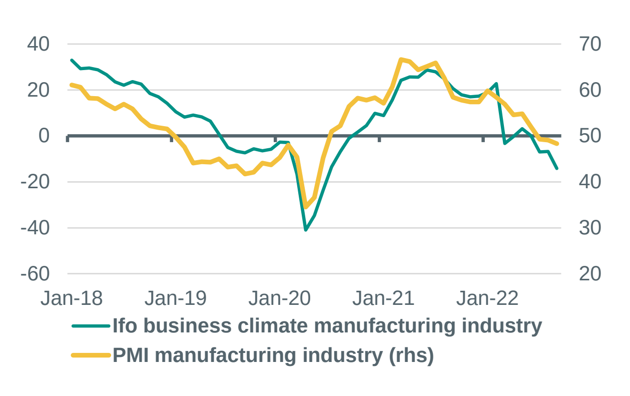
Aline Schuiling – Senior Economist | aline.schuiling@nl.abnamro.com

- **The eurozone economy seems to be slowing down rapidly, which is in line with our base scenario of a recession in the coming quarters**
- **The ECB has stepped up the pace of rate hikes. In our revised base case, we see another 75bp hike in October, followed by a 50bp step in December.**

The eurozone economy seems to be deteriorating rapidly, now that most of the post-pandemic rebound in consumption has materialized and households' real disposable income and corporate profitability are being eroded by soaring energy bills. Moreover, the economy will suffer from the impact of tightening financial conditions and a slowdown in world trade on the back of aggressive central bank rate hikes. The volume of private consumption increased by 1.3% qoq in Q2, which was higher than expected and was due to a sharp rebound in services consumption. Household income data for Q2 have not yet been published, but it is likely that the rise in consumption went hand in hand with a further drop in the savings rate. Fixed investment expanded as well in Q2 (+0.9% qoq), but excluding volatile investment in Ireland, eurozone investment expanded by 0.3% only. Looking forward, we expect consumption and fixed investment combined to decline during the three quarter period 2022Q3-2023Q1. Drops in consumer and business confidence and in the composite PMI have all pre-signalled contraction in GDP in the next few quarters.

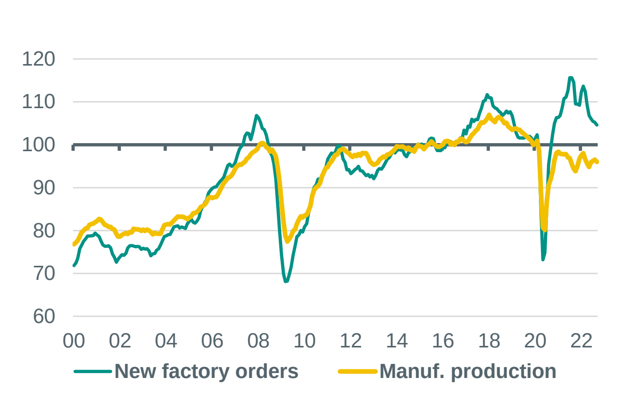
Inflation increased to 9.1% yoy in August, up from 8.9% in July. Core inflation increased to 4.3% yoy, up from 4.0% in July. Recent developments led to declines in the energy and food components of the HICP, but inflation was lifted by surging gas prices and the filtering through of past jumps in food and energy prices into services and manufactured goods prices. Looking forward, we think that the rise in inflation has not yet ended and that the peak could be reached in September-October, with inflation subsequently easing somewhat. Nevertheless, inflation should remain elevated throughout this year and we see it declining more significantly in 2023. The impact of high energy and food prices filtering through into core inflation is different from the second round longer-term effect that would result from high inflation leading to wage growth that is well above labour productivity growth. We think that this second effect will be more moderate as the outlook for employment growth is deteriorating rapidly and an expected rise in the unemployment rate should limit wage growth.

German business confidence continues to weaken…



Source: Refinitv, ABN AMRO Group Economics

…leading to declines in factory orders



Source: Refinitv, ABN AMRO Group Economics

The ECB raised its key policy rates by 75bp at its September meeting, as expected. It also signalled that 'based on its current assessment, over the next several meetings, the Governing Council expects to raise interest rates further to dampen demand'. In the press conference, ECB President Lagarde suggested that the terminal rate could be reached in the December or February meetings. She added that market expectations for the terminal rate (somewhat above 2%) were not far off the ECB's thinking. We upgraded our view of the ECB rate peak. We now expect the ECB to raise its deposit rate to 2% most likely by end-2022. In our revised base case, we see another 75bp hike in October, followed by a 50bp step in December. The policy rate then settles at 2% through 2023. The most likely alternative to this base, is three steps of 50bp, with the terminal rate being reached in February 2023. We had previously signalled a peak rate of 1.5%. We saw the risks to our previous peak rate call as being skewed to the upside, but we see the risks to our new forecast as being balanced.

The Netherlands: Government steps in to soften the blow

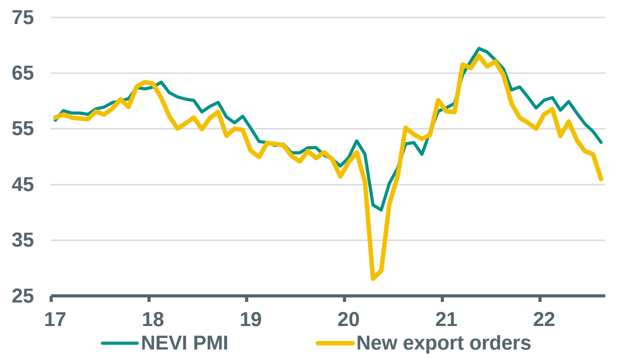
Jan-Paul van de Kerke – Economist | Jan-Paul.van.de.kerke@nl.abnamro.com
Aggie van Huisseling – Economist | aggie.van.huisseling@nl.abnamro.com

- **The government steps in with significant support packages to ease the purchasing power shock**
- **This softens, but does not prevent, a broad-based slowdown towards end-2022 and early 2023**

In the second calculation by Statistics Netherlands, the stellar Q2 growth rate of 2.6% qoq was maintained. We expected a slight downward adjustment given revisions in recent figures due to economic volatility. This Q2 growth rate provides a solid basis for the second half of 2022, in which we expect a considerable slowdown in growth, ultimately leading to a small GDP contraction at the end of 2022 and start of 2023. For now, we maintain our full-year growth forecasts of 4.7% in 2022 and 0.5% in 2023. We expect this slowdown to be broad-based, led by external demand – reflecting our view of a serious recession in the eurozone including Germany (most important export destination). We already see this materializing in new export order components of producer confidence indices. Zooming in on sectors that are either energy intensive (chemicals and metals) or those integrated more strongly into global supply chains (textiles, transport), the drop in confidence is more profound. With the deterioration of external demand to continue over the coming months, we expect business owners to halt investments. Also in more domestically orientated sectors which take on a large share of investments, such as housing/real estate, we expect a cooling of investment activity, in part driven by the tightening of financial conditions.

New export orders signal deterioration of demand

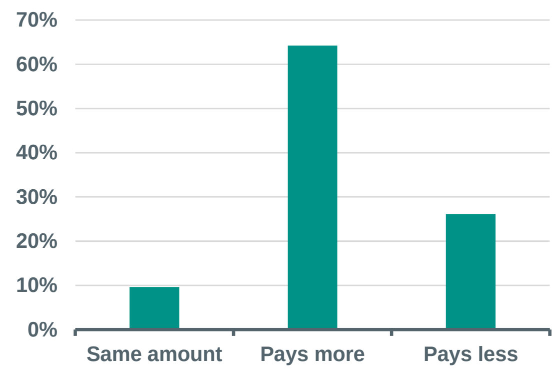
Nevi PMI, index (50 = neutral mark)



Source: ABN AMRO, Refinitiv

Two-thirds of households face higher energy bill

% of households, August, yoy comparison



Source: ABN AMRO Transaction data

Turning to the consumer side, with inflation (HICP) hitting 13.6% yoy in August and consumer confidence reaching a new low for the fifth consecutive month this year, one would expect the slowdown in consumption to already be more pronounced. Consumption growth is indeed slowing down, and our anonymised spending data for August and the first weeks of September point towards a continuation of this trend, but a sharp decline has not taken place yet. This is in part caused by the differences between the official inflation measure and the inflation rate that consumers experience 'on the ground'. Around 50% of the current official inflation figure is caused by energy prices, but not everyone sees this reflected in the energy bill yet. In a previous article (see here), we signal that on average energy bills in August 2022 were up 26% yoy, which differs sharply from the 151% yoy increase reported by Statistics Netherlands. Still, as time passes, more and more households will face higher energy prices. This means that we still expect consumption to contract slightly at the end of the year. However, the extent to which consumption is hit depends on how big the blow to purchasing power will be.

On this year's *'Prinsjesdag'*, the government announced a budget containing a EUR 17bn (2% of GDP) support package which will soften the blow to households' purchasing power significantly. The budget contained tax relief through measures such as lower levies on gasoline, as well as handouts for the poorest. Meanwhile, the minimum wage was raised by 10%. The budget was outdated the moment it was presented, as a price ceiling for energy up until a usage threshold was announced additionally. As a lot remains unclear regarding this price ceiling, we hold on to our current growth forecasts. However, we believe this package to significantly ease the burden on households, especially those on the lower end of the income range, which will contain the expected drop in consumption. If any, this package combined with the stronger pickup in wage growth supported by the higher minimum wage risks fuelling demand more than what optimal policy would prescribe in an inflationary environment in which the supply side is constrained by, for instance, the historically tight labour market.

US: Landing softly – so far

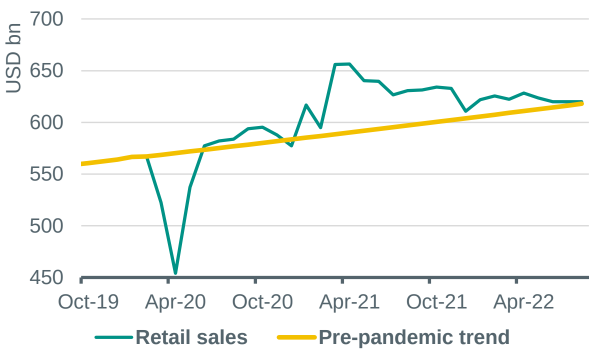
Bill Diviney – Senior Economist | bill.diviney@nl.abnamro.com

- **Softening demand, and easing supply bottlenecks, suggest the economy is gradually cooling off**
- **Even so, the labour market remains exceptionally tight, meaning the Fed's job is not yet done**
- **We expect the fed funds rate upper bound to hit 4.5% by December, but still expect rate cuts in 2023**

The overheated US economy is gradually cooling off. Goods consumption was largely stagnant in real terms over July-August, and we estimate that it is now basically back at trend – following nearly two years of well above trend demand. This comes against a backdrop of an easing in most supply-side bottlenecks, with PMI delivery times now back to normal, and pipeline cost pressures easing – both materials and logistical services cost growth has come down. At the same time, the cooling in the economy has not been disorderly, at least so far – despite the abrupt U-turn in monetary policy early this year. While the composite PMI plunged in August, the September flash reading – though still weak – was a big improvement, and suggested that the August data were an anomaly. The US economy is, in short, achieving a largely soft landing in our view.

All of this by no means suggests the Fed's inflation-fighting job is done. Indeed, the August inflation data surprised market expectations to the upside, with falling petrol prices offset by a rebound in goods inflation, and a continued firming in housing rents. We expect core services inflation – particularly housing and medical – to remain strong over the coming year. However, overall inflation is likely to cool down, as the various easing pipeline pressures (lower commodity prices, the strong dollar, easing bottlenecks) meet stagnant consumer demand. The main upside risk to the inflation outlook continues to come from the labour market. The August payrolls report suggested some modest improvement, with a rise in participation helping to nudge the unemployment rate a little higher, to 3.7% from 3.5% in July. Wage growth also eased a touch, although it remains well above levels consistent with the Fed achieving its 2% inflation target. Strong wage growth is being driven to a large extent by excess labour demand – job vacancies remain far too high relative to the number of job seekers. As such, the labour market is still a long way from where the Fed needs it to be comfortable with the inflation outlook.

Goods consumption has fallen back to trend…



Source: Refinitiv, ABN AMRO Group Economics

…while manufacturing delivery times have normalised

PMI, index

Source: Refinitiv, ABN AMRO Group Economics

Indeed, the Fed tilted further in a hawkish direction at the September FOMC meeting, with the upper bound of the fed funds rate projected to reach 4.5% by the end of the year. The projections also showed policy staying restrictive throughout the forecast horizon, with no rate cuts seen until 2024, and policy still above neutral even in 2025. Despite this, we continue to think the Fed is likely to modestly cut rates in H2 2023. We expect a steeper rise in unemployment than the FOMC projects, to c.5% by end-2023. Given the lags with which monetary policy affects the economy – the labour market being the last domino to fall – we think the Fed will be confident that the economy is cooling sufficiently by the middle of next year. As such, we continue to expect around 100bp in rate cuts in H2 2023, although the higher level from which the Fed would be cutting means we are now likely to end 2023 at 3.5% in the upper bound of the fed funds rate, up from our previous 3% expectation. In the near term, the risks to policy continue to be to the upside, with more tightening necessary if the labour market does not cool in line with our forecasts. However, the tighter policy stance than we previously expected also raises the risk of a deeper downturn further out, and potentially larger rate cuts if inflation also moves more quickly back to target.

UK: Confidence crisis

Bill Diviney – Senior Economist | bill.diviney@nl.abnamro.com

- **Unease over the new government's budget plans has driven a dramatic selloff in UK assets**
- **The Bank of England will be forced to hike rates aggressively over the coming months – potentially to well beyond our new base case of 4%. This could lead to a catastrophic bust by 2024**

It has been a tumultuous month for the UK economy and financial markets. In particular, the market's verdict was resoundingly negative on the new government's plans to unleash a wall of debt-fuelled stimulus on a supply-constrained economy (see also here). Bond yields surged to new post-financial crisis highs, while money markets now expect the Bank of England to raise its policy rate to 5.5% by next summer. Ordinarily, the currency would strengthen on such a rise in interest rate expectations; instead, the value of sterling has plunged – against the dollar to a 37 year low. The plans to freeze annual energy bills for the average household at c.£2500 and support for business energy bills may help the economy avoid a deep recession in the very near term. But this delays the pain rather than avoids it. There is now a real risk that the Bank of England will be forced to raise rates much more aggressively than even our updated forecast of 4%, for two reasons. One is that the reduced hit to real incomes from the energy price cap, as well as the demand stimulus stemming from the biggest tax cuts since the 1970s, means that inflation is likely to stay above the 2% target well beyond 2023. The second reason is that the plunge in sterling is an even bigger near-term risk to the inflation outlook, given that the UK is a net importer of goods with a sizeable trade deficit. If the MPC does not follow through on current market expectations for 250bp in rate hikes at the coming two meetings, sterling could weaken further still, exacerbating the inflation outlook. Rate rises that go well beyond our 4% projection raises the risk of a catastrophic bust further down the line – with a deep recession by 2024.

Much will now depend on how policymakers react to the crisis in UK assets. The first line of defence has been the Bank of England, which issued a statement on Monday stating that the Bank 'will not hesitate to change interest rates by as much as needed'. The BoE has since intervened in gilt markets, and we still would not rule out an emergency, inter-meeting rate hike to stabilise sterling. Ultimately, a U-turn on the policy measures announced by the government is the only fundamental fix to the problem. While politically this would represent an embarrassing climbdown, it might prove to be the least worst option for the government.

Interest rates to rise to 4%, and potentially far beyond

Bank Rate, %; yellow line represents our forecast

Source: Refinitiv, ABN AMRO Group Economics

The labour market has tightened further

Source: Refinitiv, ABN AMRO Group Economics

Economy has continued to weaken, but inflationary pressure has strengthened

Meanwhile, the economy has continued to weaken, with the mild contraction in output that began in Q2 likely to continue in Q3 – fulfilling the technical recession definition. This is partly due to the extra public holiday because of the Queen's funeral in September, but activity indicators even before this have also suggested declines in output – retail sales have continued their downward trend, manufacturing has stagnated, and the PMIs have all fallen below the 50 mark separating expansion from contraction. Despite this, the labour market has remained remarkably tight, as despite a modest fall in job vacancies, the inactivity rate has continued to rise, leading to a net increase in overall tightness as measured by the job vacancy ratio. Wage growth also continued to pickup to 5.4% y/y, while core inflation accelerated further to a new 30 year high of 6.3%. Given all of this, and even in the absence of this month's fiscal stimulus announcement, the Bank of England would in any case have been minded to continue tightening monetary policy aggressively.

China: Some positive signals, but headwinds remain firm

Arjen van Dijkhuizen – Senior Economist | arjen.van.dijkhuizen@nl.abnamro.com

- **Recent data for retail sales, investment and the unemployment rate brought some positive signals**
- **Still, headwinds from real estate, Covid-19 policy and slowdown global growth constrain rebound**
- **Conclusion of CCP Summit in October may bring more room for a gradual exit from 'zero-Covid'**

After weak July data, macro data for August were a bit better. Retail sales re-accelerated, the unemployment ratio came down a bit and the stepping up of support was visible in a pick-up in infrastructure investment. Still, the data also showed that headwinds from strict Covid-19 policy and real estate problems remain firm, with property sales and investment still in the doldrums. We think the rebound from the lockdown slump in March/April will bring above trend qoq growth in 2H-22, particularly in Q3, with the stepping up of support gradually filtering through. That said, the drags from Covid-19/real estate and the slowdown in global demand will make this post-lockdown rebound a much less spectacular one than that of 2020.

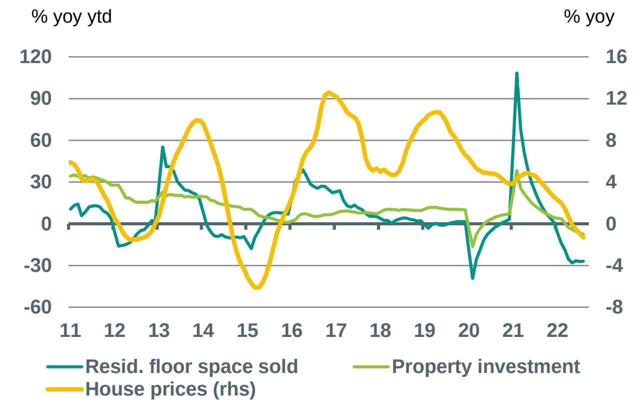
Retail sales show some improvement, but property sector data are still ugly

Given Beijing's adherence to strict Covid-19 policy in the run-up to the CCP Summit in October (see below), pandemic flare-ups with new variants led to new regional lockdowns over the summer months. Still, the nationwide lockdown intensity has remained below last spring's levels, when megacity Shanghai was in a lockdown for five weeks or so. Also, measures have been taken to mitigate the impact of lockdowns on production and transport, while local governments have been told to put more emphasis on safeguarding growth while containing the pandemic. However, the rolling lockdowns are leaving a clear mark on consumer confidence and demand (the recent recovery in retail sales is largely due to special measures boosting car sales), and added to the property sector downturn, visible for instance in still lacklustre property sales and investment data. Growing distrust in developers' capacity to finish construction projects even resulted in a mortgage boycott. For the property sector to stabilize, it will prove crucial that support measures taken (like cutting the benchmark rate for mortgages, supporting financing for healthy developers and increasing leeway for local governments to support real estate) will help finalizing current construction projects, restoring trust in the sector and mitigating systemic risks from rising defaults.

Retail sales rebound from lockdown slump

Source: Bloomberg

Real estate data still ugly



Source: Bloomberg

A prelude to the 20th CCP Congress in October

From 16 October, the CCP's 20th National Congress will be held in Beijing. A key outcome of this summit, held every five years, is the selection of party members into policy committees. In 2018, presidential term limits were abolished; this now looks to pave the way for a third term for President Xi Jinping. After the summit, we see more room for a gradual exit from 'Zero-Covid', or at least a more pragmatic approach, which was also recently advocated by China's Centre for Disease Control and Prevention. It is also crucial how other key policies will evolve under Xi's third term: how will the government move in the trade-off between mitigating systemic risk from real estate versus reducing moral hazard and capping leverage, how much focus will Beijing keep putting at strategic concepts such as *common prosperity* and *dual circulation*, will the crackdown on internet companies continue and – last but not least – how will China position itself in foreign economic and geopolitical affairs. We will cover these and other questions in our regular and/or special China publications going forward.

Key views on a page

The energy crisis in Europe has intensified, and we 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. Governments are now stepping in more aggressively to help households and businesses, but high inflation means that central banks may need to tighten monetary policy even further to offset this. Upside inflation risks mean the Fed and ECB are in any case likely to continue raising rates rapidly at coming meetings. Europe will also continue to feel the global spill-over effects of much tighter US monetary policy, pushing bond yields higher, equity markets lower, and weighing on growth.

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 75bp rate hike at the September meeting, we expect another 75bp rate hike in October, followed by a final 50bp hike in December. This will take the deposit rate to 2%, where we expect it to peak. We have not pencilled in any rate hikes after that as the economy is expected to move into recession. This should do much of the heavy lifting in terms of fighting inflation. 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 – High growth in the second quarter of 2022 is maintained in the second statistical calculation. Regardless, we still expect a significant growth slowdown towards the end of 2022 and beginning of 2023. Consumers will face a reduction in purchasing power, in part because every month as fixed price contracts expire, more and more households are confronted with higher energy prices. The policy measures announced on ‘Prinsjesdag’ will soften the blow to consumers but cannot prevent a small downturn.	**Fed** – Given persistently elevated inflation in the US, and upside risks to the outlook, we expect the Fed to hike rates a further 75bp in November, and 50bp in December, with the upper bound of the fed funds rate to peak at 4.5%. Subsequently, we expect the Fed to pause, assuming inflation is moving back towards its 2% target, with modest rate cuts expected in H2 23. Near-term risks are to the upside, both in the rate hike pace and in the peak rate. The Fed continues to unwind its balance sheet at a $95bn monthly pace.
UK – Unease over the new government’s budget plans has driven a dramatic selloff in UK assets. The Bank of England will be forced to hike rates aggressively over the coming months – potentially to well beyond our new base case of 4%. While growth will be helped in the near-term by a freeze in household energy bills, this could be more than offset by potentially much tighter monetary policy than we currently have in our base case. This would have deeply damaging effects on the economy, as households in the UK are highly exposed to rising interest rates.	**Bank of England** – The growing risk of a wage-price spiral in the UK led the MPC to hike rates by 50bp at the September meeting. We now expect a further 75bp hike in November, with Bank Rate to peak at 4% by year end. Turbulent market conditions mean that there is a significant risk the Bank has to tighten policy much more aggressively, both to stem currency weakness and to offset fiscal stimulus recently announced by the government. Current market pricing suggests rates could peak as high as 6%, which would likely cause a severe recession.
US – The overheated US economy is gradually cooling off. Demand is softening and supply side bottlenecks continue to ease. With that said, the cooling in the economy has not been disorderly, and the labour market remains exceptionally tight. We expect underlying demand cool further 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, pipeline pressures are easing.	**Bond yields** – Despite the recent jumps in bond yields, we still think the peak is in sight for both Treasury and German bunds. Thereafter, we expect weaker economic indicators to put downward pressures on yield with the 10y Bund yield falling to 1.55% and the 10y UST to 3.4% in Q4 2022. However, as short-term rate expectations continue to rise, we expect a stronger inversion of the Treasury curve and the Bund curve to bear-flatten before steepening again in H1 2023 once the market starts to price out multiple rate hikes in the course of next year.
China – August data brought some positive signals, with retail sales re-accelerating. Still, the data also showed that headwinds from Covid-19 policy and real estate remain firm, with property sales and investment still very weak. We think the rebound from the lockdown slump in March/April will bring above qoq growth in 2H-22, particularly in Q3, with the stepping up of support gradually filtering through. That said, the drags from Covid-19/real estate and the slowdown in global demand will make this post-lockdown rebound a much less spectacular one than that of 2020.	**FX** – An energy crisis and 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. The recent wave of risk aversion pushed EUR/USD below parity due to safe haven demand for the dollar. When financial markets calm down somewhat again, lower safe haven demand for the dollar could result in a recovery of EUR/USD. Our forecasts for EUR/USD for end 2022 stands at 1.0.

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	↓ 8.2	↓ 4.0
Eurozone	-6.2	5.2	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	↓ 8.7	↓ 6.6
China	2.2	8.1	3.7	5.6	China	2.5	0.9	2.5	2.5
Netherlands	-3.9	4.9	↓ 4.6	0.5	Netherlands	1.1	2.8	10.0	5.0
Policy rate	**26/09/2022**	**+3M**	**2022e**	**2023e**	**10Y interest rate**	**26/09/2022**	**+3M**	**2022e**	**2023e**
Federal Reserve	3.25	↑ 4.50	↑ 4.50	↑ 3.50	US Treasury	3.88	3.40	3.40	↑ 2.60
European Central Bank	0.75	↑ 2.00	↑ 2.00	↑ 2.00	German Bund	2.09	1.55	↑ 1.55	1.35
Bank of Japan	-0.10	-0.10	-0.10	-0.10	Japanese gov. bonds	0.25	0.25	0.25	0.25
Bank of England	2.25	↑ 4.00	↑ 4.00	↑ 4.00	UK gilts	4.25	4.00	↑ 4.00	↑ 3.25
People's Bank of China	3.65	3.60	3.60	3.60					
Natural resources	**26/09/2022**	**+3M**	**2022e**	**2023e**	**Currencies**	**26/09/2022**	**+3M**	**2022e**	**2023e**
Brent - Oil USD/barrel	84.1	↓ 100	↓ 100	120	EUR/USD	0.96	1.00	1.00	1.10
WTI - Oil USD/barrel	76.7	↓ 95	↓ 95	115	USD/JPY	144.8	130	130	120
Henry Hub - Gas USD/mn	6.90	6.0	6.0	6.0	GBP/USD	1.08	↓ 1.10	↓ 1.10	↓ 1.20
TTF - Gas EUR/MWh*	182.2	↑ 115	↑ 115	90	EUR/GBP	0.89	↑ 0.91	↑ 0.91	↑ 0.92
Gold - USD/oz	1,622	1,700	1,700	1,900	USD/CNY	7.14	6.80	6.80	6.50

Source: Refinitiv, Bloomberg, ABN AMRO Group Economics * Brent, WTI, Henry Hub: active month contract; TTF: next calender year

Macro Research Team

Sandra Phlippen, Chief Economist | sandra.phlippen@nl.abnamro.com
Aggie van Huisseling, Economist | aggie.van.huisseling@nl.abnamro.com
Aline Schuiling, Senior Economist | aline.schuiling@nl.abnamro.com
Arjen van Dijkhuizen, Senior Economist | arjen.van.dijkhuizen@nl.abnamro.com
Bill Diviney, Senior Economist | bill.diviney@nl.abnamro.com
Jan-Paul van de Kerke, Economist | jan-paul.van.de.kerke@nl.abnamro.com
Nick Kounis, Head of Financial Markets Research | nick.kounis@nl.abnamro.com

FX & Rates Research

Georgette Boele, Senior FX & Precious Metals Strategist | georgette.boele@nl.abnamro.com
Sonia Renoult, Rates Strategist | Sonia.renoult@nl.abnamro.com