

Economy Watch

Is Europe on the Cusp of a Recession?

September 14, 2022



Some of the critical questions and issues we will be answering today

- Which European economies may see a recession?
- What kind of recessions are likely?
- What is driving the economic downturn?
- What are the upside and downside risks?



Today's Speakers



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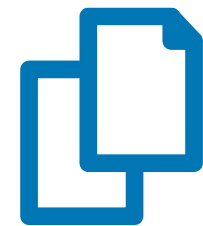
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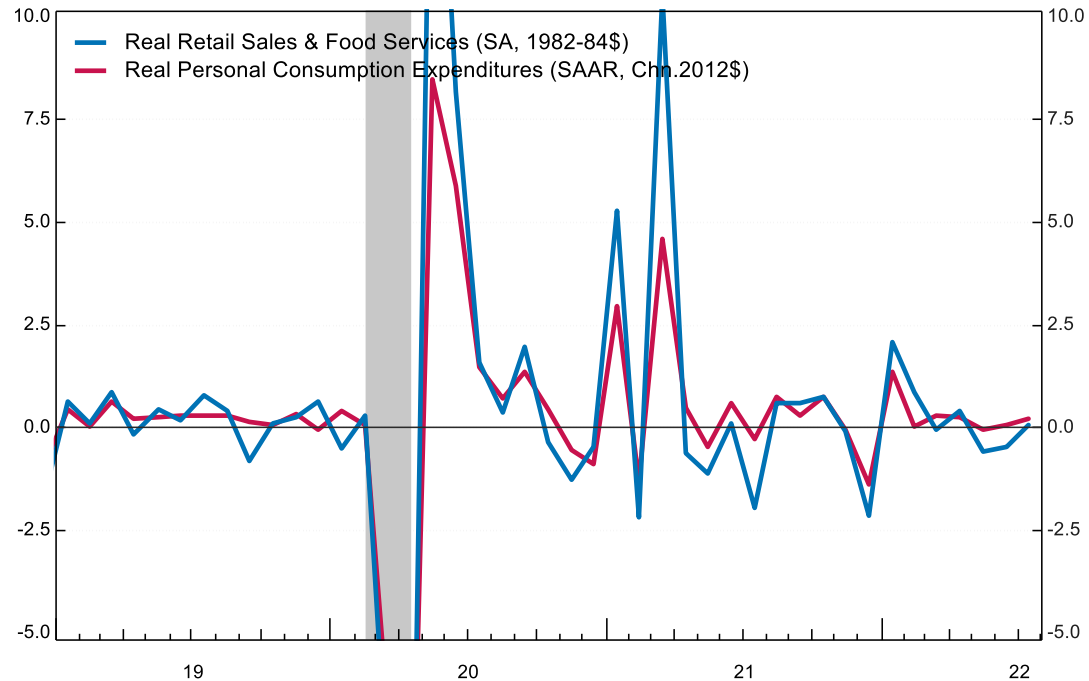
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US Outlook

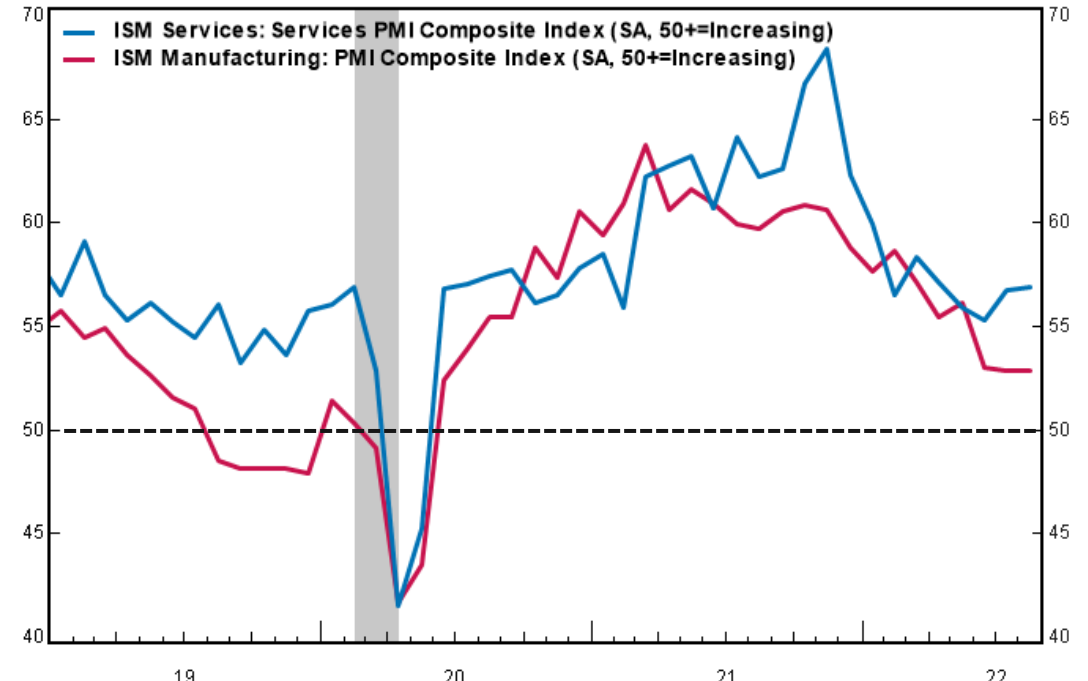
Consumption starting to struggle, but business activity continues to expand.

Real Retail Sales & Personal Consumption Exp. (%m/m)



Sources: C/BLS/H, BEA

ISM Manufacturing & Services PMI (Expansion > 50)



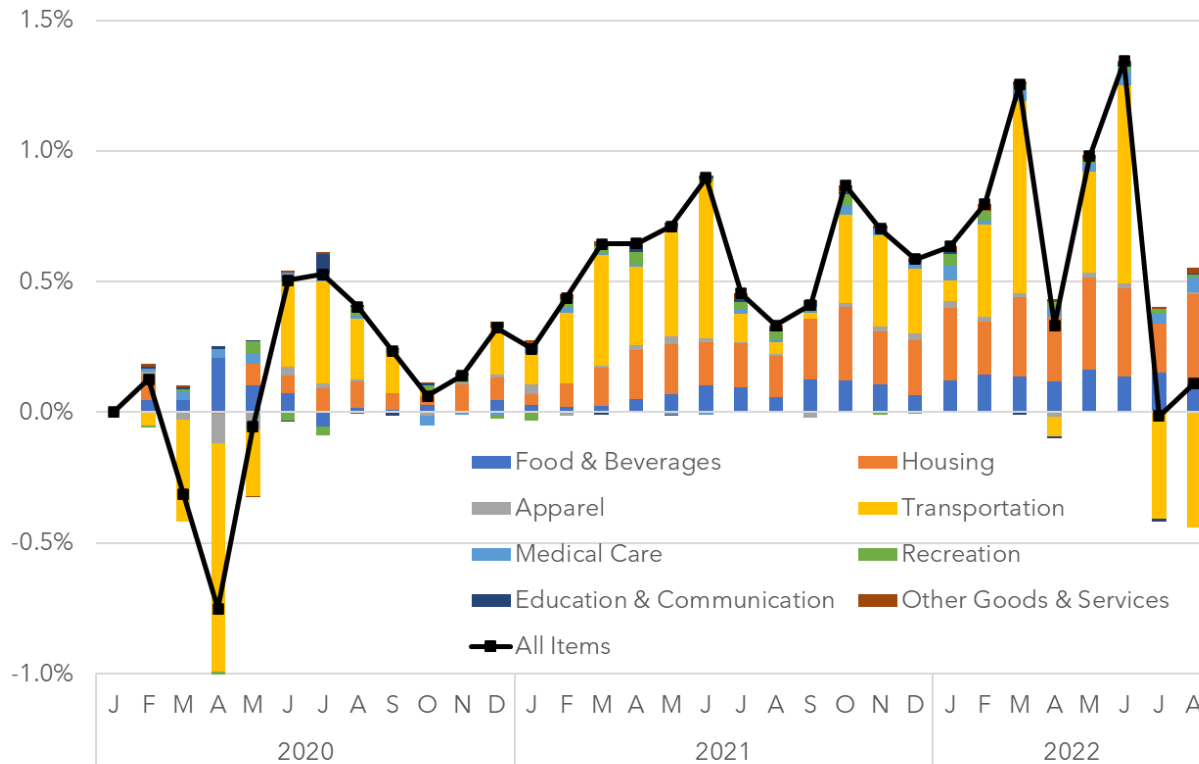
Source: Institute for Supply Management

- Businesses in both manufacturing and services are continuing to report expansion, but that growth is softening.
- Headwinds from high inflation and rising interest rates are eating away at US household consumption growth.



While inflation may have topped-out in Q2 2022, the problem will not disappear.

Contributions to Month-over-Month CPI Growth (%)



Source: BLS, The Conference Board

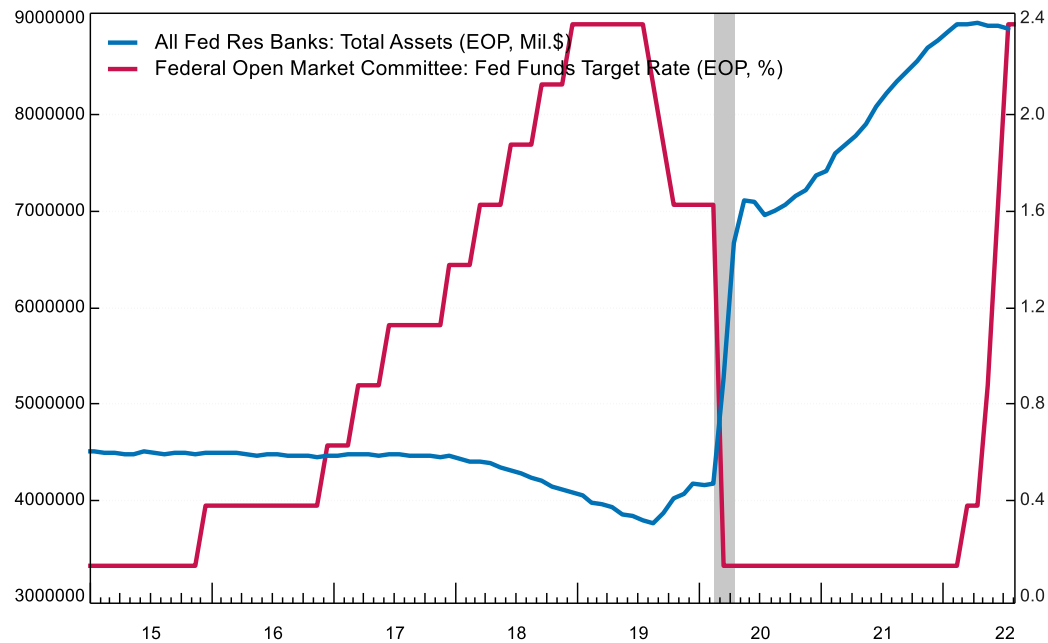
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- US inflation intensified in H1 2022 as food and energy prices spiked due to the war in Ukraine. However, these commodity prices have begun to decline.
- Supply chain bottle necks associated with COVID-19 shutdowns in China are also moderating (but could reemerge).
- Thus, we think year-over-year inflation rates likely peaked in Q2 2022.
- However, the high inflation problem is not going to disappear anytime soon.
- Inflation rates will remain well above the Fed's 2 percent target through the end of 2023.



Fed tightening: short-term rates will enter restrictive territory soon.

Fed Funds Rate (RHS) and Fed Balance Sheet (LHS)



Source: Federal Reserve Board

TCB Fed Funds Forecast

		Fed Funds Window		Delta	Average	
		Lower	Upper			
2022	Jan	0.00	0.25	0.00	0.125	Accommodative
	Mar	0.25	0.50	0.25	0.375	
	May	0.75	1.00	0.50	0.875	
	Jun	1.50	1.75	0.75	1.625	
	Jul	2.25	2.50	0.75	2.375	Neutral
	Sep	3.00	3.25	0.75	3.125	Restrictive
Nov	3.25	3.50	0.25	3.375		
Dec	3.50	3.75	0.25	3.625		
2023	Jan	3.75	4.00	0.25	3.875	
	Mar	3.75	4.00	0.00	3.875	
	May	3.75	4.00	0.00	3.875	
	Jun	3.75	4.00	0.00	3.875	
	Jul	3.75	4.00	0.00	3.875	
	Sep	3.75	4.00	0.00	3.875	
Nov	3.75	4.00	0.00	3.875		
Dec	3.75	4.00	0.00	3.875		

- Persistently high inflation readings will likely force the Federal Reserve to raise the Fed Funds rate well into “restrictive” territory (over 3%). This more aggressive stance is likely to drive the US economy into a short and mild recession before 2022 ends.
- However, we still expect inflation readings to remain above the Fed’s 2 percent target through the end of 2023.



The US economy is not in a recession yet, but will be soon.

THE CONFERENCE BOARD US ECONOMIC OUTLOOK, 2019-2020-2021-2022-2023
Percentage Change, Seasonally Adjusted Annual Rates*

	2020				2021				2022				2023				2019*	2020*	2021*	2022	2023
	I Q*	II Q*	III Q*	IV Q*	I Q*	II Q*	III Q*	IV Q*	I Q*	II Q*	III Q	IV Q	I Q	II Q	III Q	IV Q					
Real GDP	-5.1	-31.2	33.8	4.5	6.3	6.7	2.3	6.9	-1.6	-0.6	0.3	-0.5	-0.5	0.5	2.0	3.0	2.3	-3.4	5.7	1.4	0.3
Real GDP (YoY)	0.6	-9.1	-2.9	-2.3	0.5	12.2	4.9	5.5	3.5	1.7	1.2	-0.6	-0.3	0.0	0.4	1.2	2.3	-3.4	5.7	1.4	0.3
Real disposable income	3.1	48.5	-16.6	-8.3	54.7	-29.1	-4.1	-4.5	-7.8	-0.6	-0.5	-1.0	-1.0	0.0	1.0	1.5	2.3	6.2	2.3	-5.7	-0.3
Real consumer spending	-6.9	-33.4	41.4	3.4	11.4	12.0	2.0	2.5	1.8	1.5	1.0	-0.6	-0.7	-0.5	1.3	1.8	2.2	-3.8	7.9	2.2	0.1
Residential investment	20.3	-30.8	60.0	34.4	13.3	-11.7	-7.7	2.1	0.5	-16.2	-10.0	-5.0	-5.0	-1.0	-1.0	0.0	-0.9	6.8	9.2	-6.0	-4.9
Nonresidential investment	-8.1	-30.3	18.7	12.5	12.9	9.2	1.6	2.9	10.0	0.0	-0.2	-1.1	-2.5	-0.9	2.5	3.4	4.3	-5.3	7.4	3.6	-0.5
Inventory change (bln chn '12\$)	-30	-253	25	89	-88	-169	-67	193	189	84	33	4	-10	-11	-14	11	75	-42	-33	77	-6
Total gov't spending	3.7	3.9	-2.1	-0.5	4.2	-2.0	0.9	-2.6	-2.9	-1.8	1.0	2.5	3.4	3.6	4.0	4.4	2.2	2.5	0.5	-1.3	2.8
Exports	-16.3	-59.9	54.5	22.5	-2.9	7.6	-5.3	22.4	-4.8	17.6	4.0	2.0	0.5	0.5	1.5	3.5	-0.1	-13.6	4.5	6.2	2.5
Imports	-13.1	-53.1	89.2	31.3	9.3	7.1	4.7	17.9	18.9	2.8	-2.0	-1.0	-1.0	-1.7	0.4	2.5	1.1	-8.9	14.0	9.0	-0.6
Unemployment rate (%)	3.8	13.0	8.8	6.8	6.2	5.9	5.1	4.2	3.8	3.6	3.6	3.6	3.7	3.9	3.9	3.7	3.7	8.1	5.4	3.7	3.8
PCE Inflation (%Y/Y)	1.7	0.6	1.2	1.2	1.8	3.9	4.3	5.5	6.3	6.5	6.3	4.2	3.4	3.0	2.9	2.7	1.5	1.2	3.9	5.8	3.0
Core PCE Inflation (%Y/Y)	1.8	1.0	1.5	1.4	1.7	3.4	3.6	4.6	5.2	4.8	4.6	4.4	3.4	2.9	2.8	2.6	1.7	1.4	3.3	4.8	2.9
Fed Funds (% , Midpoint, Period End)	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.375	1.625	3.125	3.625	3.875	3.875	3.875	3.875	1.625	0.125	0.125	3.625	3.875

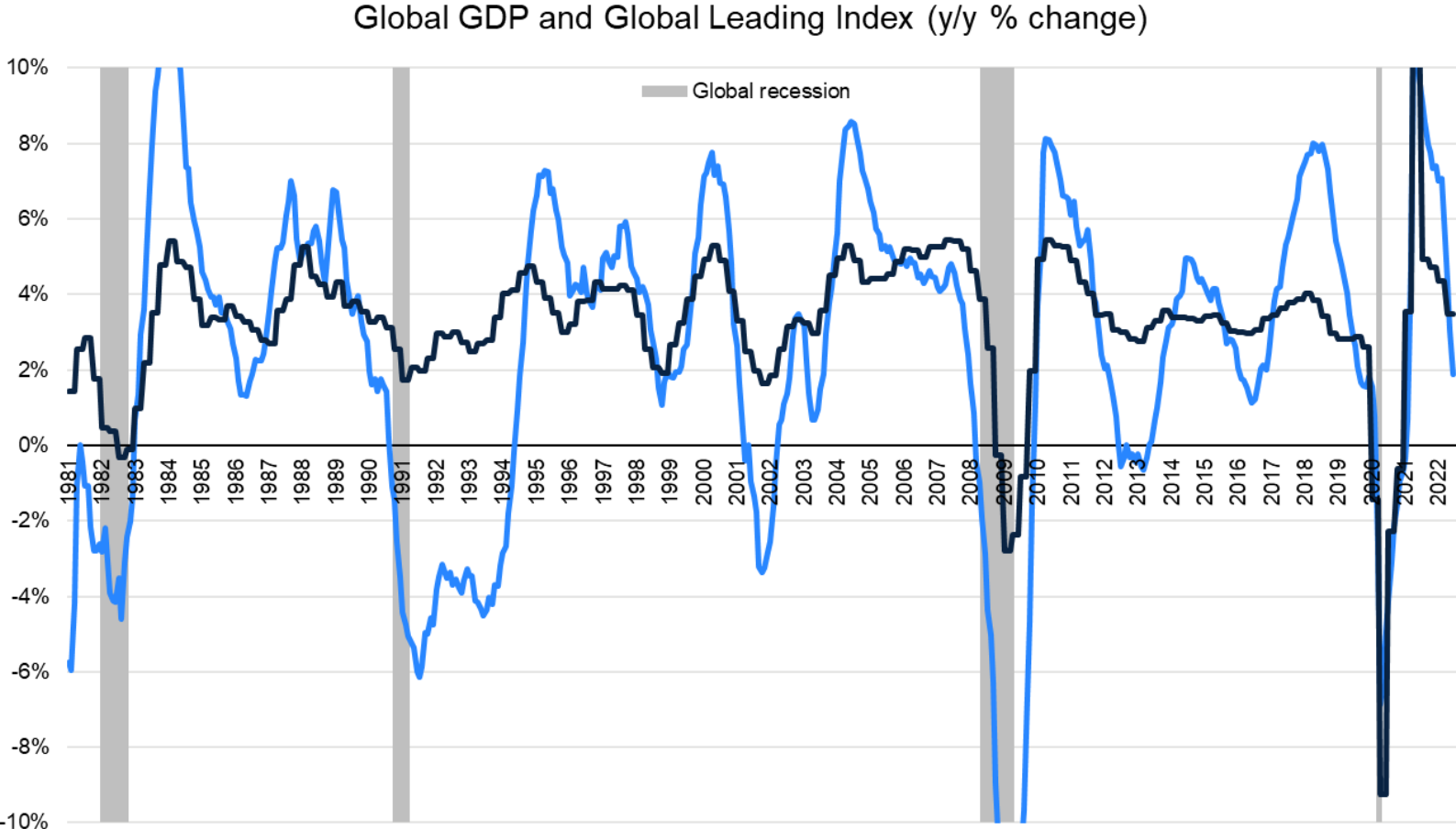
Source: The Conference Board

*Units: Quarterly growth rates are QoQ SAAR unless otherwise noted.
Annual growth rates are year-over-year unless otherwise noted



Global Outlook

Global GDP and LEI still in expansionary territory through June, though rapidly declining and recession signals for some economies are starting to emerge

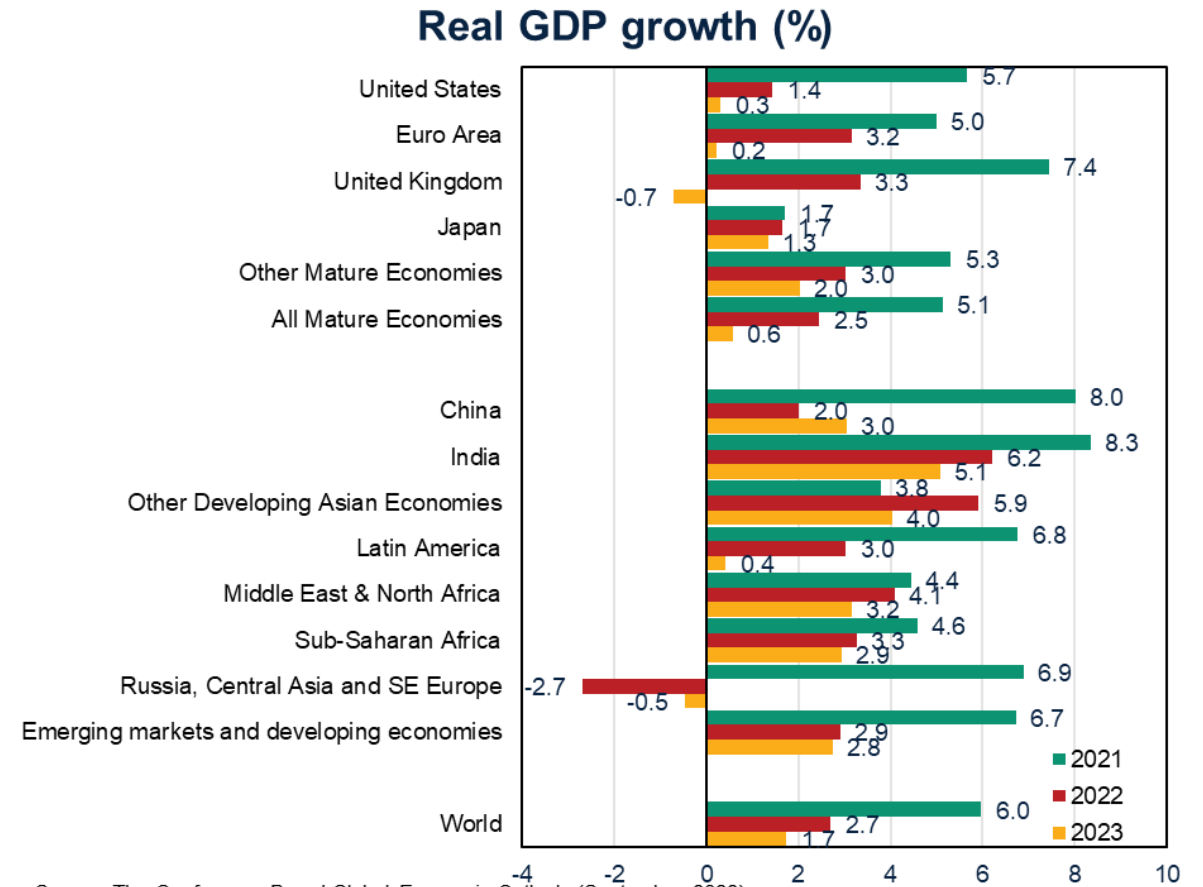


Note: Data through June 2022; Shading denotes global recessions.
Source: The Conference Board.



Global growth expected to slow but global recession is not in our base case

- Global GDP growth for 2023 is expected to slow to 1.7 percent – well below the 3.1 percent growth of the past decade (before the pandemic) but above global recessionary territory.
- Areas expected to slow the **most**
 - ✓ Parts of Europe, including the UK, Germany and generally Eastern Europe
 - ✓ United States
 - ✓ Several EMs, including Brazil and Turkey
- Areas expected to slow the **least**
 - ✓ India and other Southeast Asian economies
 - ✓ Sub-Saharan African economies
 - ✓ Gulf region economies



Source: The Conference Board Global Economic Outlook (September 2022).

Notes: Regional GDP growth rates are aggregated using shares in nominal PPP converted GDP; Chinese growth estimates are based on alternative estimates, see Harry Wu, China's Growth and Productivity Performance Debate Revisited—Accounting for China's Sources of Growth with a New Data Set, The Conference Board, 2014. The data was updated and revised in September 2021 and the historical data series are available through The Conference Board Total Economy Database; United States (Adjusted) refers to our alternative GDP series, which are revised upward as they are based on alternative price deflators for ICT investment goods and services; Indian fiscal year begins in April, so the reported fiscal year growth rate refers to Q2-Q4 of year t and Q1 of year t+1 of the calendar year.

Source: [The Conference Board Global Economic Outlook \(September 2022\)](#).

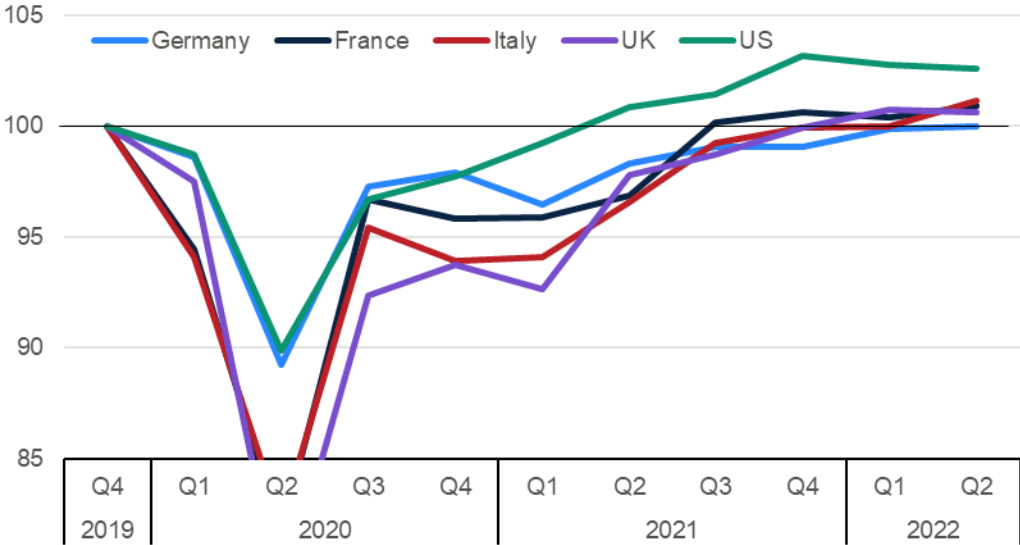


Is Europe on the cusp of a recession?

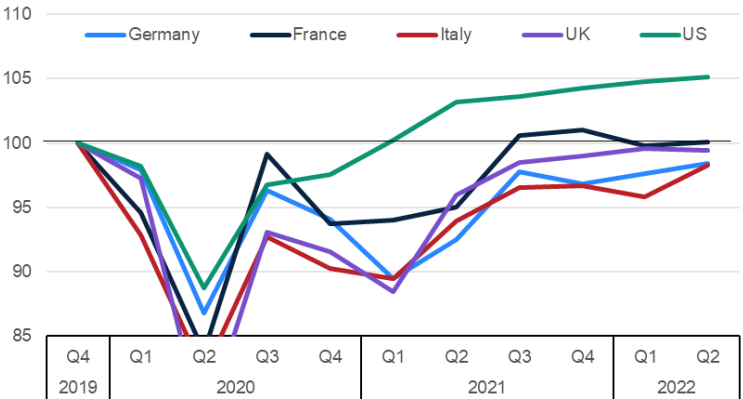
Audience Poll Question

The recovery in economic activity in Europe lags the US mostly in private consumption

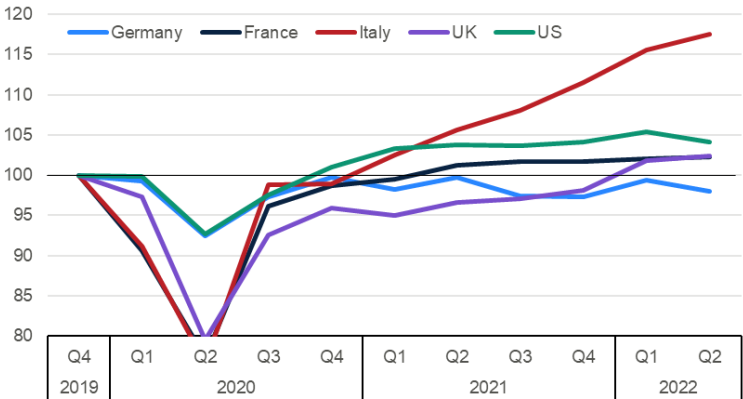
Real GDP (2019 Q4=100)



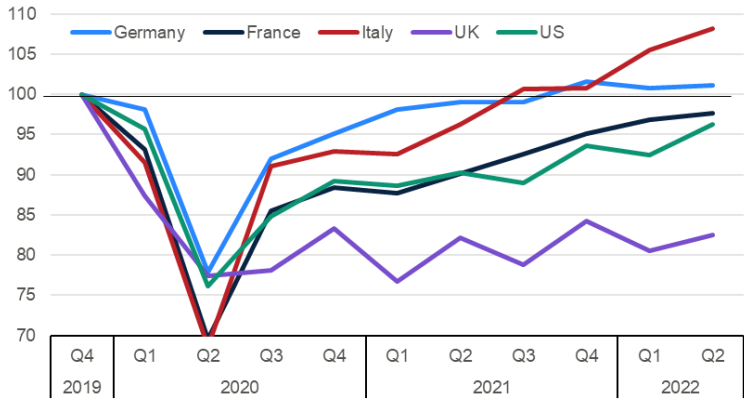
Real private consumption (2019 Q4=100)



Real Investment (2019 Q4=100)

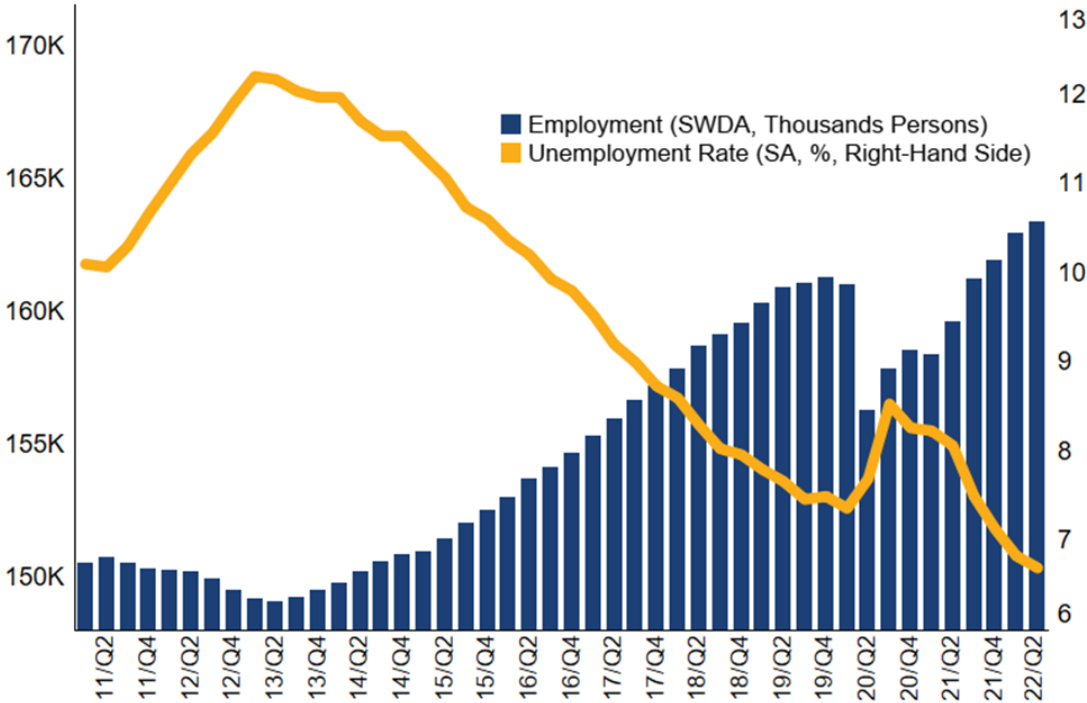


Real Exports (2019 Q4=100)



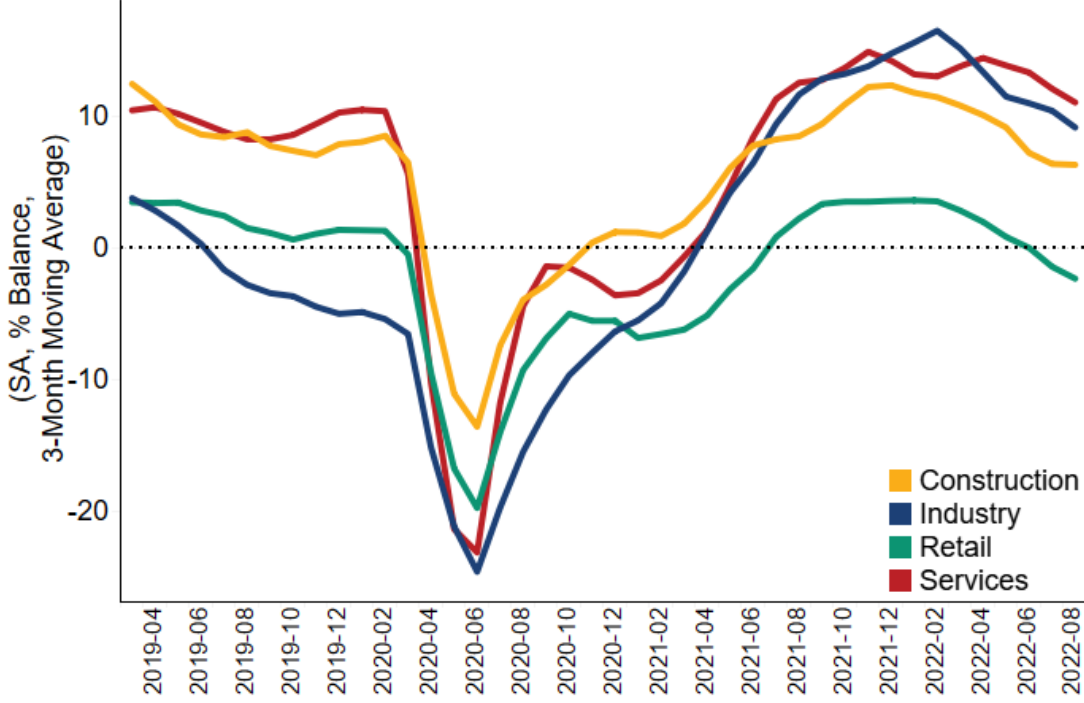
The European labor market is currently red-hot, though it may cool over the coming months

Euro Area



Source: Eurostat, Haver Analytics

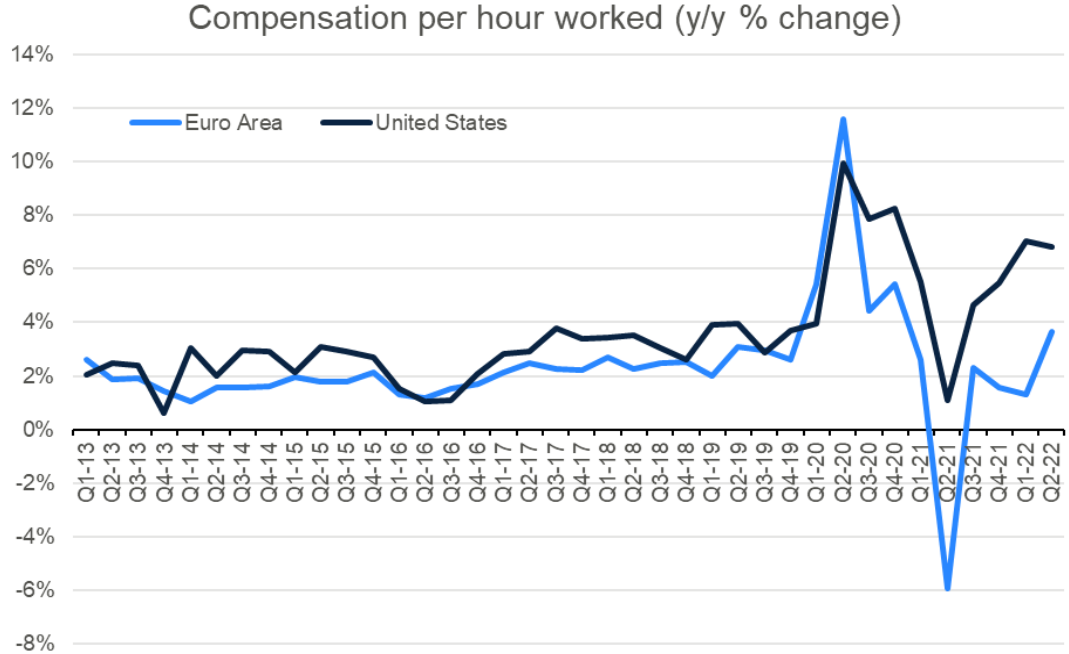
Euro Area: Employment Expectations



Source: European Commission, Haver Analytics, The Conference Board calculations



Unlike in the US, wages in the Euro Area have not meaningfully picked up yet, but this may change in 2023



Note: Variables used are compensation of employees from the national accounts and employee hours.
 Source: The Conference Board calculations using data from Eurostat, BEA and BLS.

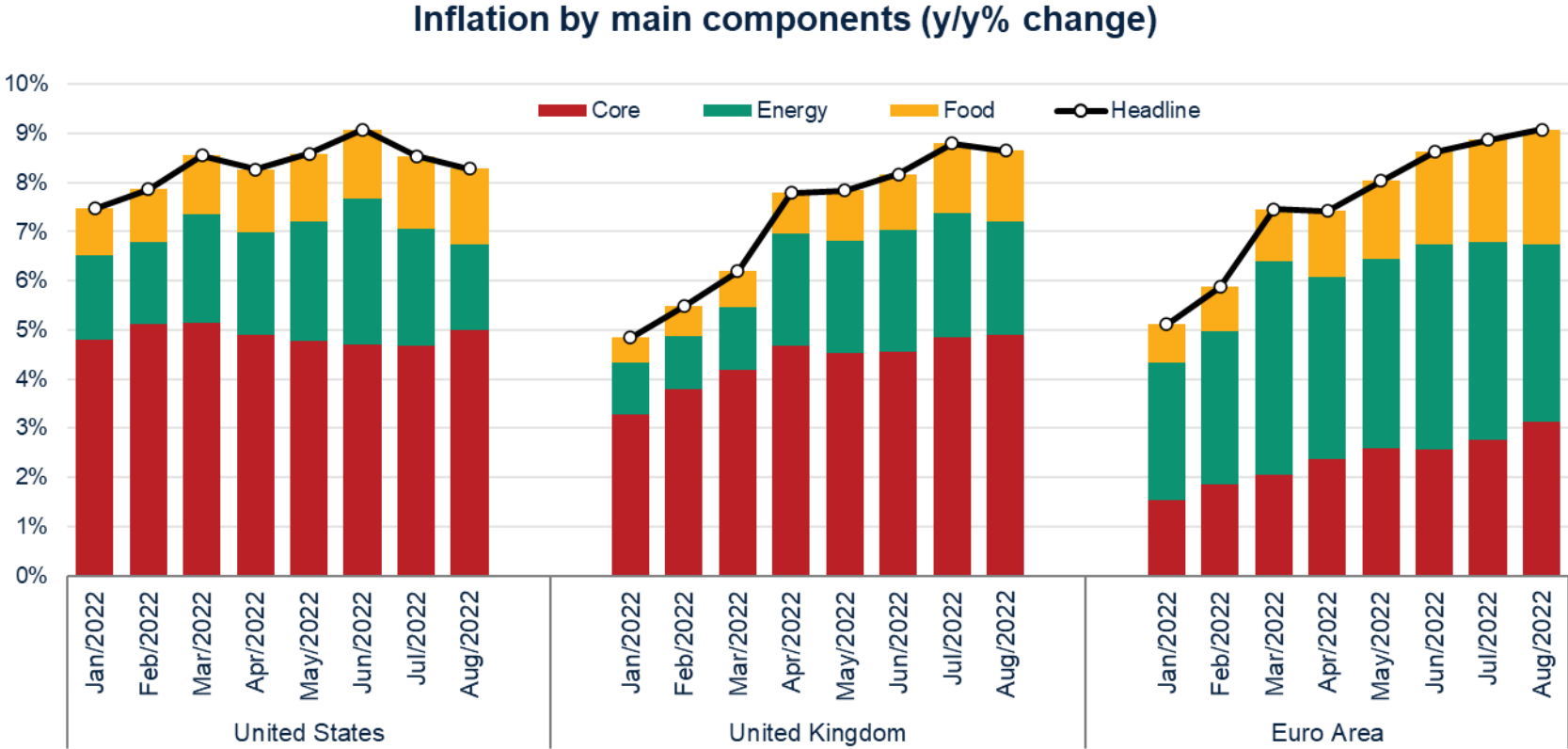
Nominal Wage Growth (%)

	2015-2019 Average	2022 (forecast)	2023 (forecast)
Hungary	5.8%	12.5%	9.9%
Poland	5.7%	10.7%	8.4%
Czechia	5.5%	10.7%	8.2%
UK	2.2%	7.8%	6.6%
Germany	2.7%	5.8%	5.0%
Denmark	1.3%	5.3%	4.6%
Sweden	2.6%	5.3%	5.3%
Spain	0.6%	6.8%	5.2%
France	1.6%	5.9%	5.0%
Italy	0.9%	6.5%	4.7%

Source: The Conference Board, OECD Economic Outlook Database (June 2022)



Inflation in the Euro Area is broadening beyond energy and food

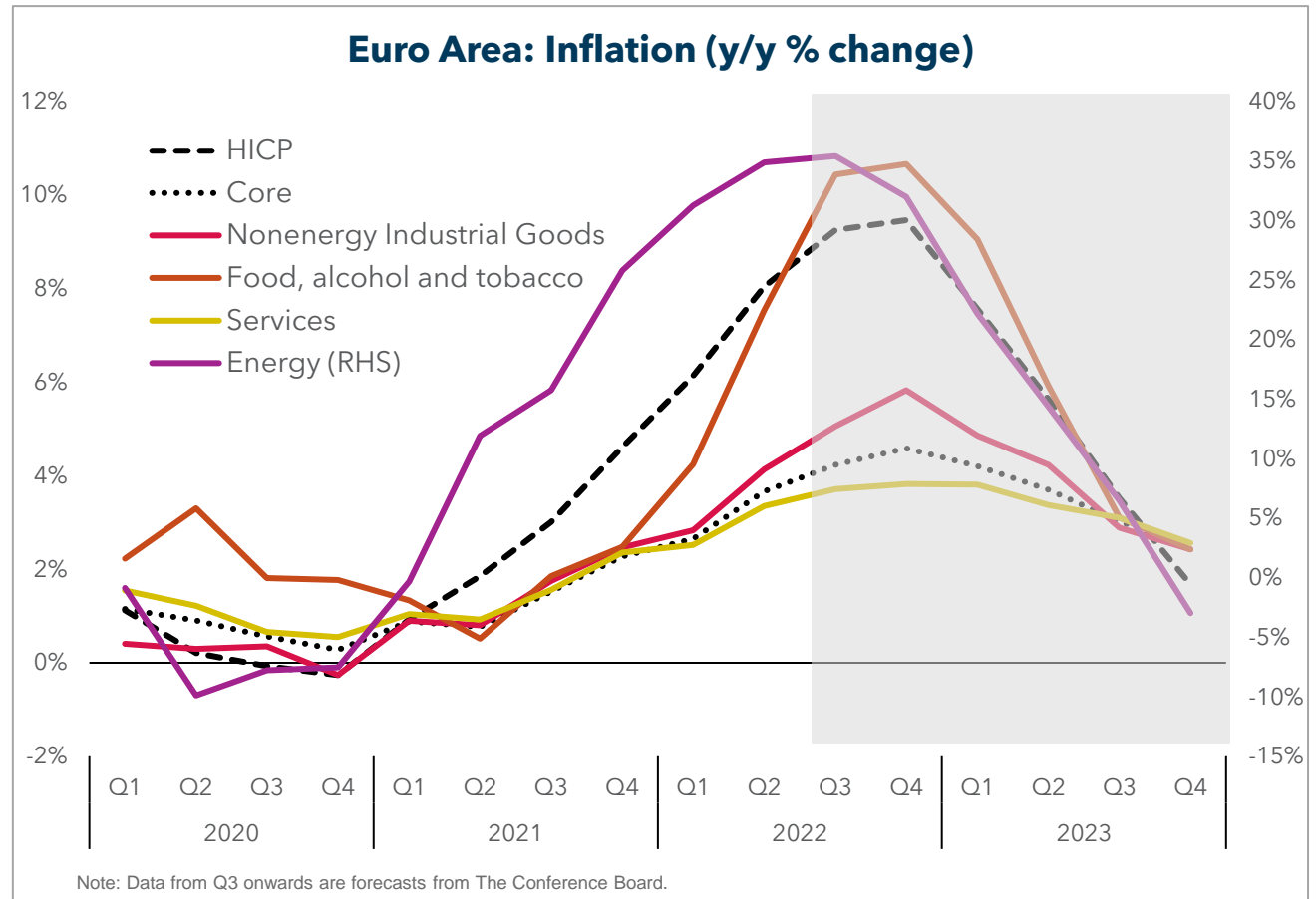


Note: Core excludes food and energy prices.
 Source: The Conference Board calculations using data from Bureau of Economic Analysis (United States), Office for National Statistics (United Kingdom), and Eurostat (Euro Area).



Inflation is likely to remain elevated for the biggest part of 2023

- Overall inflation in the Euro Area is at a record high 9.1 percent, well above the ECB's medium-term target of 2 percent. As a net energy importer, a large part of the current yearly inflation rate is due to increases in energy. Food prices have also spiked considerably partly due to the war in Ukraine.
- Annual core inflation at 3.7% in August also indicates price pressures are broadening and are not temporary.
- The Conference Board expects average annual inflation to exceed 8 percent in 2022 and will remain elevated for the biggest part of 2023.

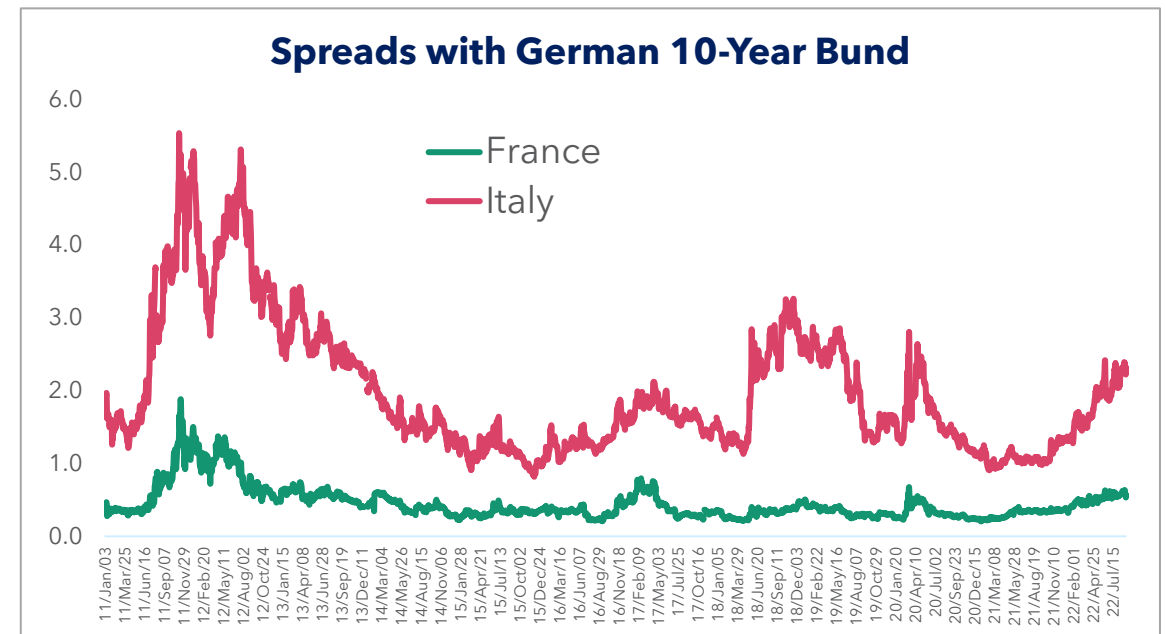
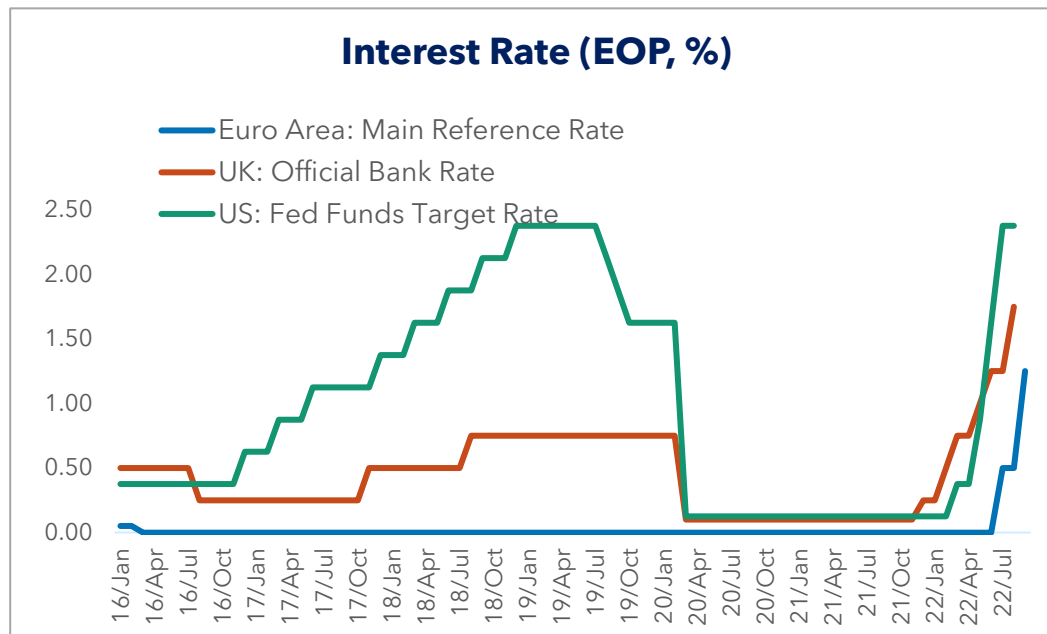


Source: Eurostat, The Conference Board Calculations



To tame inflationary pressures, the European Central Bank has tightened its monetary policy

- Following a decade long of negative deposit rates, the ECB has hiked its main rate twice, from -0.5 to 0.75 percent. More future rates are likely to come but will likely be less aggressive.
- ECB's monetary tightening does not come without cost. Despite setting a uniform rate for member states, the actual rate countries pay to refinance their debt can diverge considerably. And this is particularly cumbersome for countries with high debts like Greece and (most importantly) Italy.

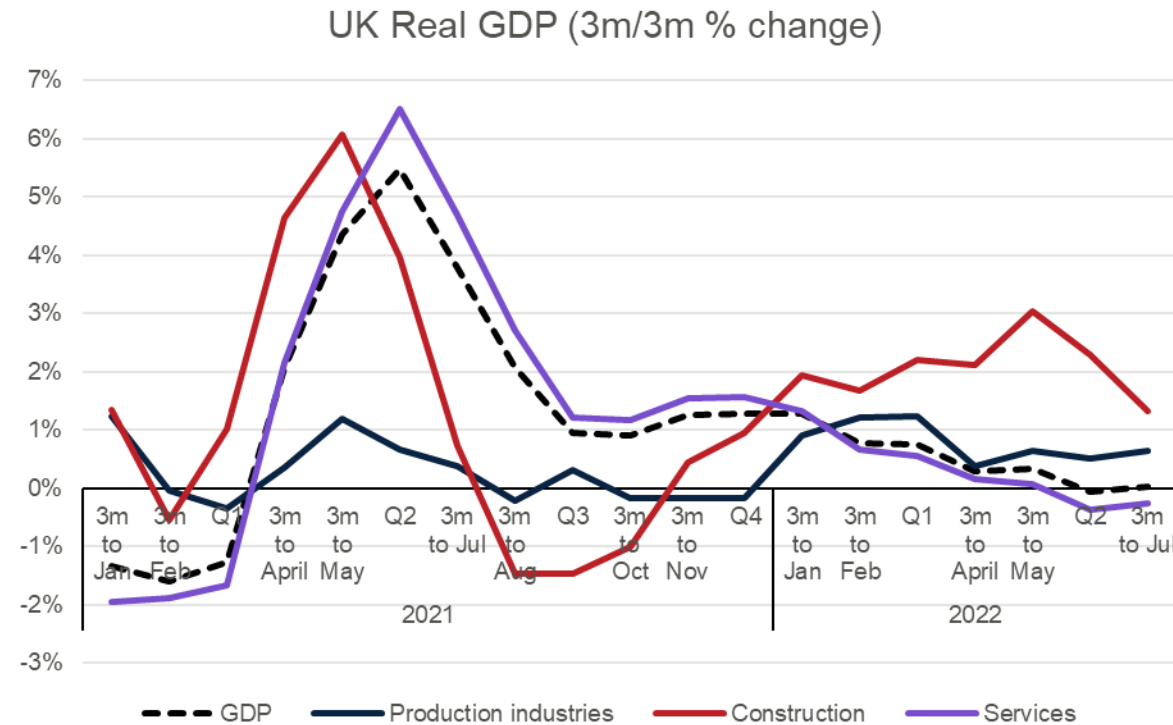


Source: European Central Bank, HAVER



The UK economy may have already entered into recessionary territory

- UK GDP (on a quarterly basis) has been in contractionary/stagnation territory since June.
- Like the Euro Area, the UK economy faces the same challenges, and even more intense, including core inflation and labor shortages. And all this while the BoE hikes much more aggressively than other central banks.
- Overall, we expect the economic outlook to remain downbeat in coming quarters, though new PM Truss' fiscal plans may alleviate some of the short-term pain.

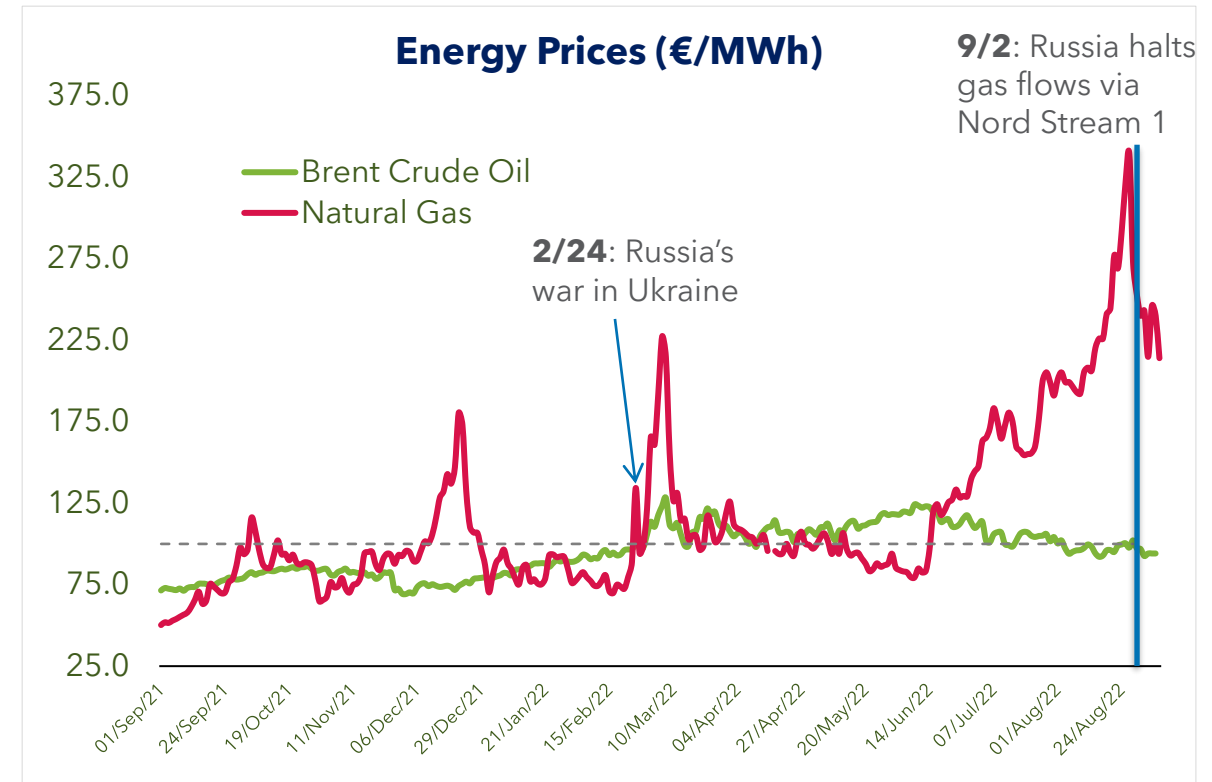
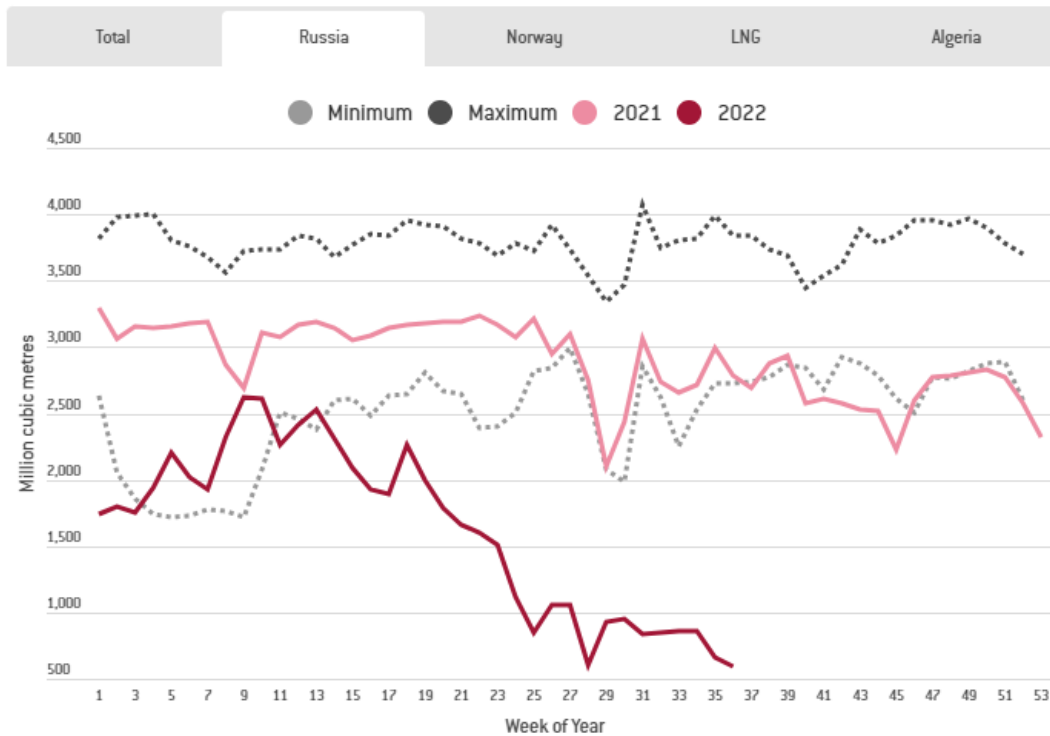


Source: The Conference Board calculations using data from ONS.



More gas cut offs in August and September push natural gas prices up further

- Last year, the EU imported 155bcm of natural gas (40 percent of its total gas supply) from Russia. This number has now dropped to 9 percent.
- However, gas storage levels are currently at 85 percent of maximum capacity.



Source: Bruegel, Haver Analytics, GIE

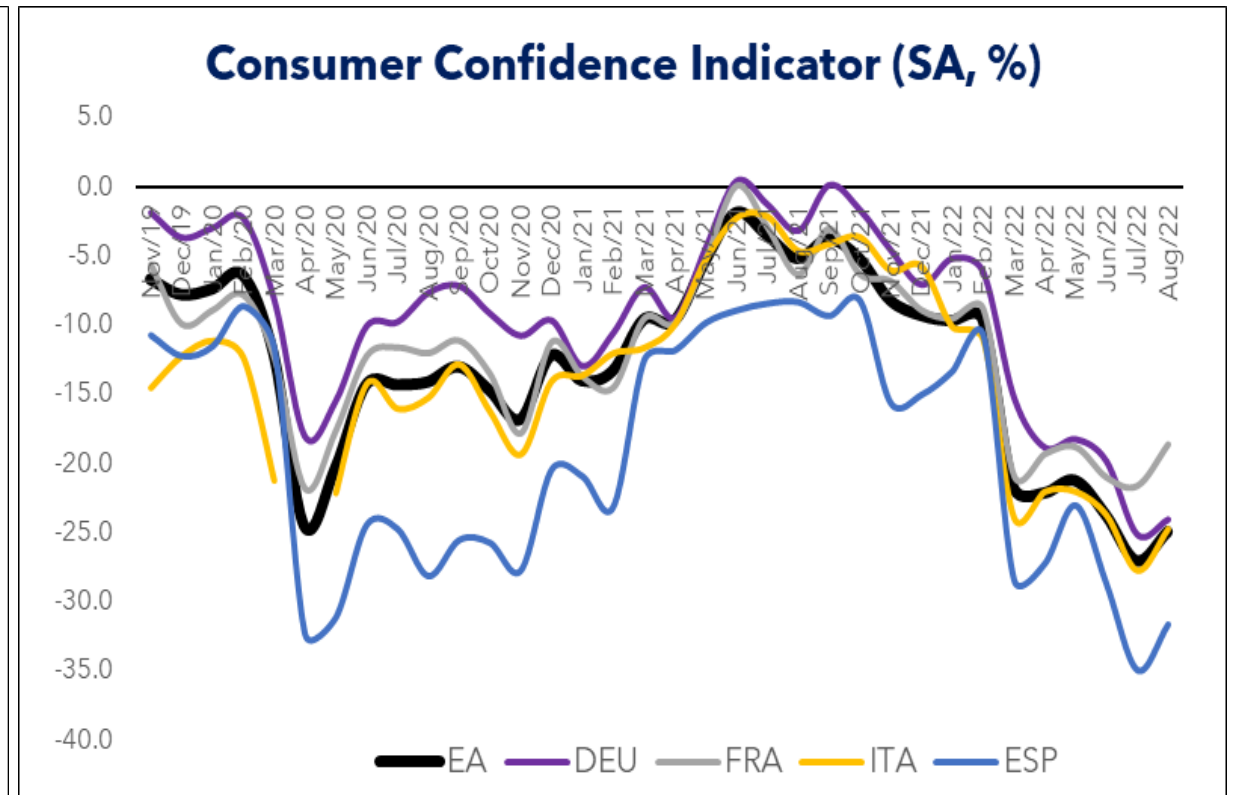
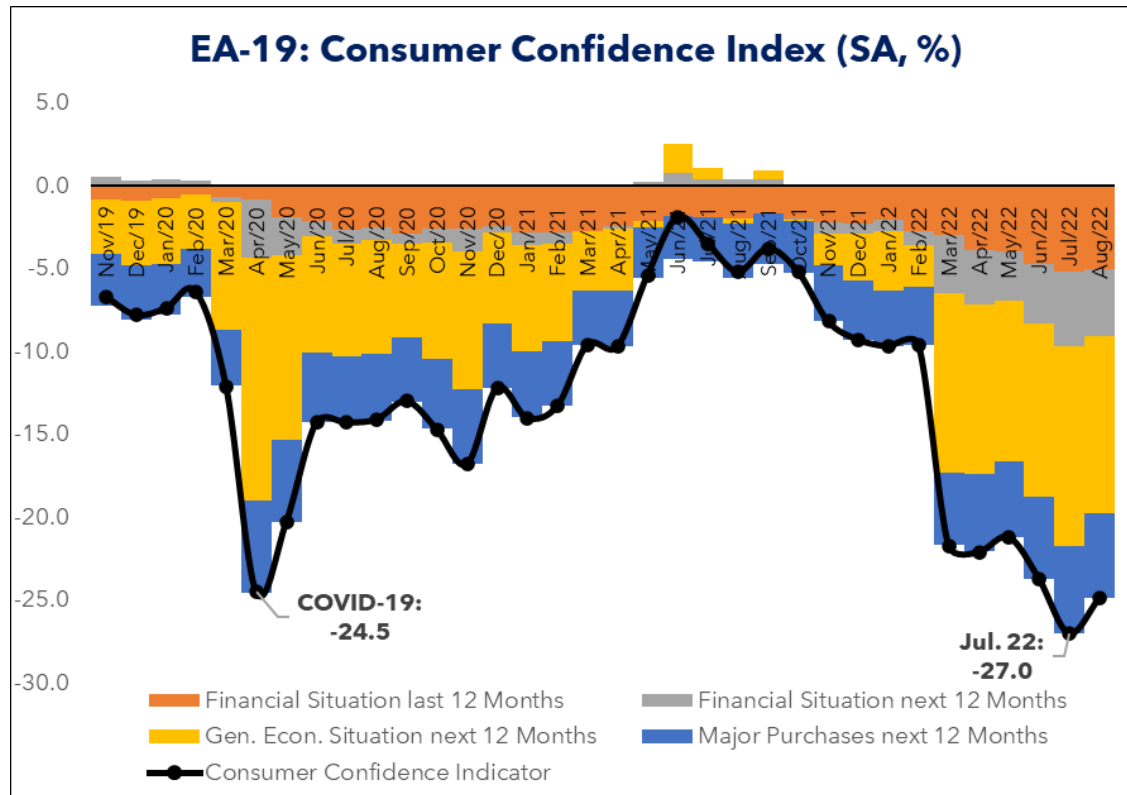


Natural gas and electricity prices crunch – EU/government plans

- **Why have electricity prices increased?**
 - Wholesale electricity prices are set by the last power plant called on to meet demand – that is, gas-fired power stations
- **What actions is the EU proposing to take?**
 - An emergency levy on revenues generated by non-gas electricity producers to raise €140bn for member states to cushion high energy costs.
 - Plans to reform the energy market, breaking the influence of gas prices on those for electricity
 - A mandatory reduction in electricity demand, like the one that was agreed for gas.
 - A key part that is missing from the current proposals is an EU-wide fiscal response. So far this is left to governments, with a wide variety of fiscal policies both in size and in measures.
- **What is the likely impact?**
 - Limiting inflationary pressures from and reducing volatility in energy/electricity prices
 - Lowering energy use partly through mandatory cuts and partly voluntarily by letting the price signal work
 - Cushion the blow to household incomes



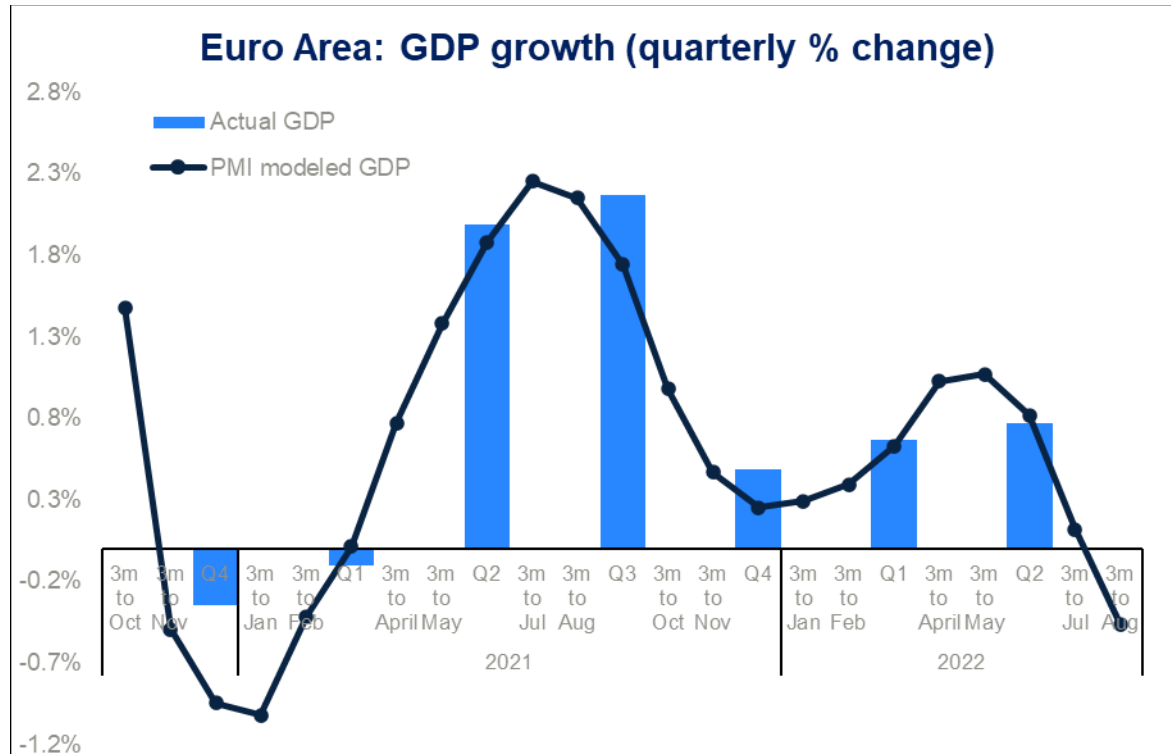
Consumer confidence lingers at historically low levels as European households suffer with a cost-of-living crisis.



Source: Eurostat, HAVER Analytics



The Euro Area is likely to enter recession later in 2022 and into early 2023



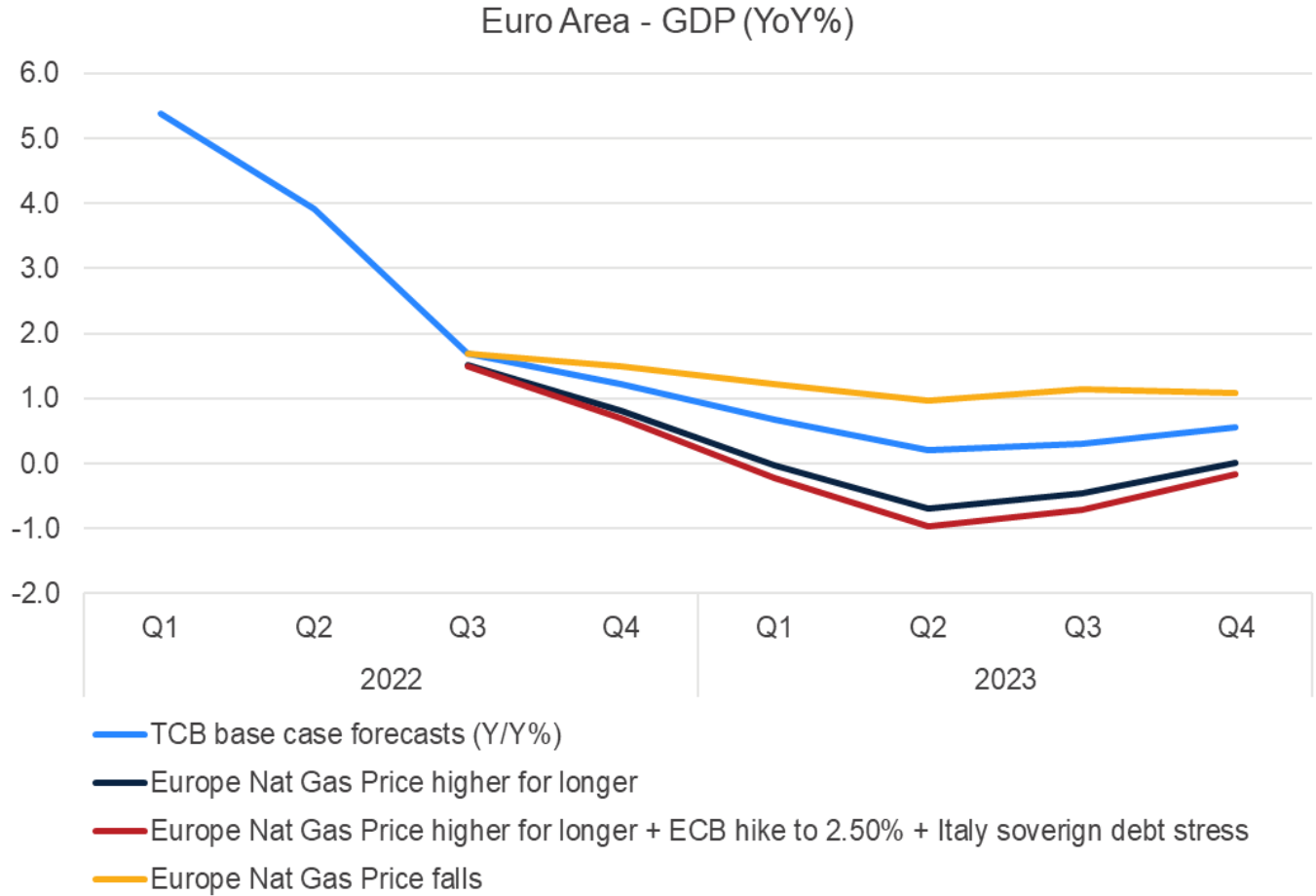
Note: PMI-modeled GDP represents GDP movements on a monthly frequency using purchasing manager indices.

Source: The Conference Board calculations using data from Eurostat and S&P Global.

- Our GDP nowcaster is pointing towards contraction in Q3.
- Recession may be unavoidable:
 - ✓ Reduction in energy use (either voluntarily or forced) dampening activity
 - ✓ Soaring energy costs dampening consumer confidence and spending
 - ✓ ECB tightening curbing lending
- However, most economies are entering it from a position of relative strength:
 - ✓ Positive household and firm balance sheets
 - ✓ Strong labor market



While a major slowdown seems inevitable, there is high certainty around the forecast, with upside and downside risks roughly balanced

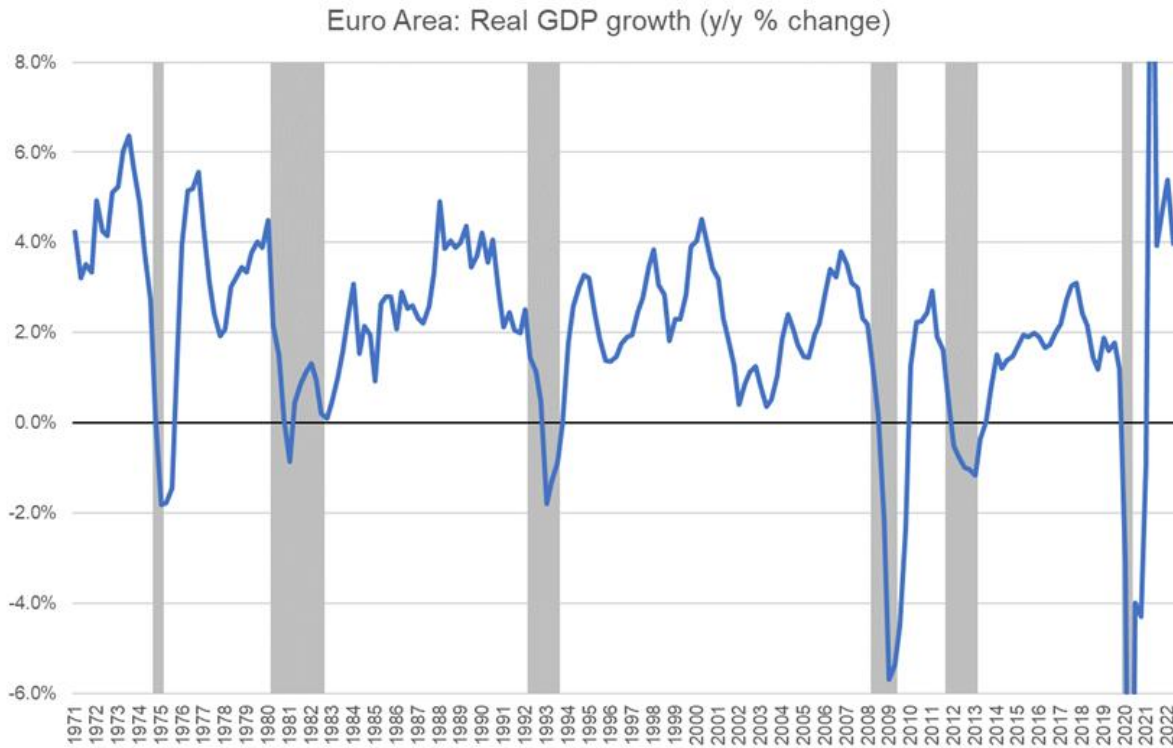


Euro Area Real GDP Growth Scenarios	YoY percent change	
	2022	2023
TCB base case forecasts (Y/Y%)	3.2	0.2
Europe Nat Gas Price higher for longer	3.0	-0.5
Europe Nat Gas Price higher for longer + ECB hike to 2.50%	3.0	-0.7
Europe Nat Gas Price falls	3.1	0.9

Sources: Eurostat, Oxford Economics, and The Conference Board estimates



How are recessions determined in the Euro Area?



- Euro Area Business Cycle Network – founded in 2003
- Defines a recession as “a significant decline in the level of economic activity, spread across the economy of the Euro Area, usually visible in two or more consecutive quarters of negative growth in GDP, employment and other measures of aggregate economic activity for the Euro Area as a whole.”
- See our [Knowledge Center](#) for more Q&A entries on the global recession



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Moderator



Erik Lundh
Principal Economist
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