

Eurozone

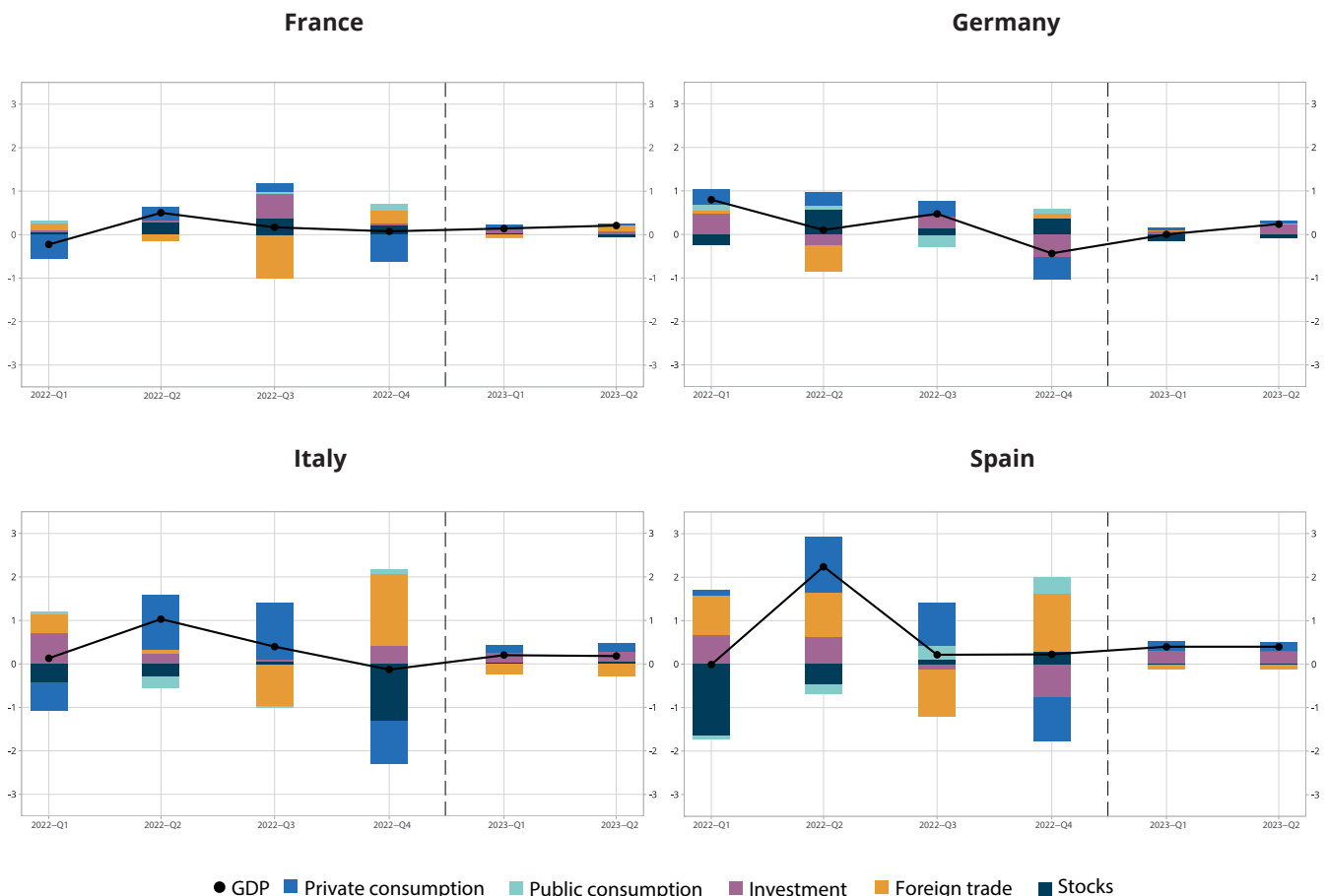
In Q4 2022, economic activity in the Eurozone was sluggish overall, penalised by the decline in household consumption

In Q4 2022, activity was generally sluggish in the main Eurozone economies, in a context of persistently high inflation, particularly with regard to energy, with consequences both for household demand and manufacturing output. In Germany and Italy, activity declined (-0.4% in Germany and -0.1% in Italy after +0.5% and +0.4% respectively in Q3, ► **Figure 1**), while in Spain and France, GDP continued to grow modestly (+0.2% and +0.1% respectively after +0.2% in Q3 in both countries), supported by a manufacturing industry that was less penalised than that of their neighbours. Domestic demand, on the other hand, fell sharply in all four countries, leading to positive variations in inventories (except in Italy where there was significant destocking) and also a positive contribution to the trend in activity by foreign trade.

Household consumption, which had driven growth in the two previous quarters, fell, or even plummeted, in the main Eurozone economies (-1.7% in Spain, -1.6% in Italy, -1.2% in France and -1.0% in Germany). Part of this decline can be attributed to energy saving by households in a context of high prices and encouragement to adopt “energy sobriety”, although in some countries they did have the benefit of particularly mild weather (► **Box 1**). In addition, the high levels of energy and food inflation may have led households to restrict their consumption of other types of goods as well as energy. Lastly, in France, Italy and Spain, households travelled abroad less, which may have brought down total consumption, as the reduction in spending abroad was not totally offset by more spending at home.

► 1. Quarterly variations in GDP and contributions of demand items

(quarterly variations in % and contributions in points)



How to read it: in France, in Q4 2022, GDP improved compared to Q3 2022 (+0.1%), and the foreign trade contributed around +0.3 points to this increase. Source: INSEE, Destatis, Istat, INE, INSEE calculations

International economic outlook

Meanwhile, investment continued to increase in France and even more so in Italy, where it probably benefited from the last months before the adjustment of the *Superbonus* scheme (which allowed households to deduct up to 110% of the cost of work in their home to improve energy efficiency; this ceiling was reduced to 90% at the beginning of 2023). Conversely, investment declined in Germany (-2.5%) and even more in Spain (-3.8%). In Germany, several days of frost late in the year penalised activity in the construction sector, while in Spain the delay in introducing the European recovery and resilience plan continued to affect this branch. Investment in equipment also fell back in both these countries.

In all four countries, foreign trade made a positive contribution to growth in Q4 2022, even though exports were sluggish (except in Italy). Imports fell sharply in Spain (-4.2%, partly due to lower spending by Spaniards abroad), Italy (-1.7%), Germany (-1.3%) and to a lesser extent France (-0.4%), in line with low domestic demand.

Inflation continues to hamper the situation for households in H1 2023

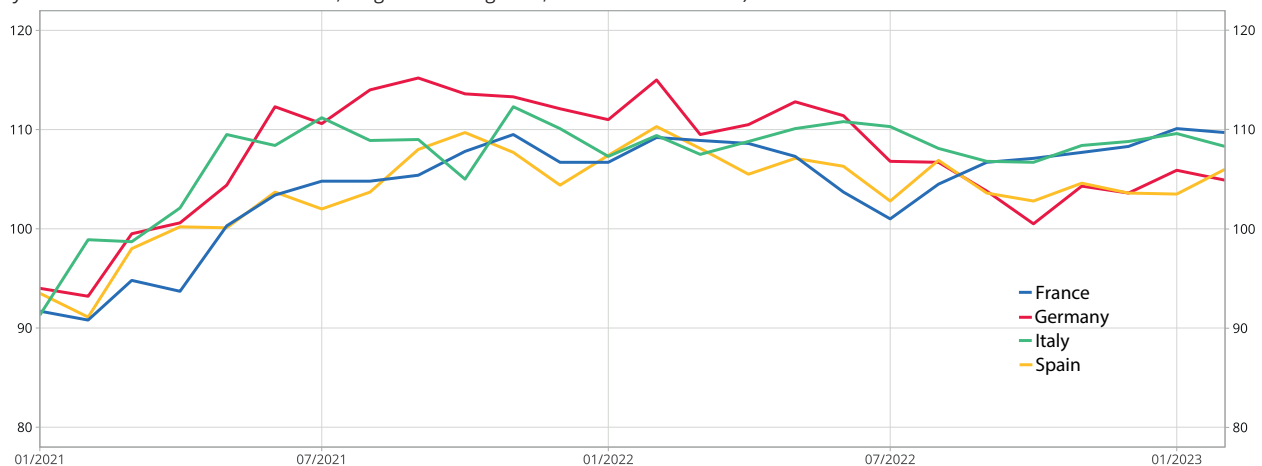
At the start of 2023, inflation was still high in the main Eurozone economies. In Spain, it fell sharply at the end of 2022, from 10.5% in August to 5.5% in December, before settling at around 6% for the last two months. In Germany and Italy the year-on-year variation in the Harmonised Index of Consumer Prices (HICP) began to decline from November, although in France it has been generally stable since the summer. Spain is therefore different as it has seen a distinct decline in the year-on-year variation in the HICP in recent months, partly due to falling prices and not only to a “base effect”. In Germany, the reduction in December of part of household gas bills resulted automatically in a drop in the HICP. Energy inflation in Germany subsequently rose again in January but headline inflation nevertheless continued to decline, driven down by transport services, before picking up again in February.

In H1 2023, inflation should continue or begin to fall back in all four countries, especially in Q2, mainly due to “base effects”: prices are expected to continue to rise –as a consequence of the higher cost of energy inputs, previous increases in commodity prices and also wage increases– but their pace of change is likely to be slower than last year. These base effects are likely to be great in Spain, where the acceleration in prices has been brisk since the start of 2022 (► **Focus** on inflation in the western economies).

In all four countries, employment improved at the end of 2022 and the unemployment rate fell or stabilised at particularly low levels. Wages too continued to be dynamic, especially in Germany with the introduction of the last increase in the minimum wage scheduled for 2022, or in France with massive payments under the value sharing bonus scheme. At the beginning of 2023, the labour market is expected to continue in the right direction in the main Eurozone economies, according to the expectations of companies in the business tendency surveys (► **Figure 2**). Growth in wages is likely to be

► 2. In January 2023, in France and Italy in particular, companies continue to expect employment to perform well

(employment indicator centred and reduced; long-term average 100; standard deviation 10)



Note: data are from outlook surveys of companies in industry and services. This monthly indicator is calculated as the weighted average of balances of opinion across all branches, balances from European surveys centralised and harmonised by the DG ECFIN, responsible mainly for seasonal adjustment. It is also centred around an average of 100 and standard deviation is set at 10. These values may therefore differ from employment climate data calculated and disseminated by INSEE from the same source but using factor analysis; the trends are similar, however.

How to read it: in February 2023, in France, the harmonised centred-reduced employment indicator was 9.7 points above its long-term average.

Source: DG ECFIN, INSEE calculations.

driven by taking rising prices into account in wage negotiations, although possibly with varying dynamics at the start of 2023 depending on the country. In Spain in particular, wages are expected to be dynamic, supported by the 8% increase in the minimum wage in January. In France, after the massive payouts under the value sharing bonus scheme at the end of 2022, wages look set to slow at the start of 2023 as a backlash. In Germany, wage negotiations that are already finalised will probably not take effect until later in the year.

Household income in current euros should therefore continue to rise in H1 2023 in the main Eurozone economies, supported by employment and especially by wage increases. However, this will not offset the continuing price rises, except in Spain, due to the strong wage increase at the beginning of 2023. All in all, household purchasing power is expected to be sluggish or may even fall back in France, Italy and Germany, but it should increase at the start of the year in Spain.

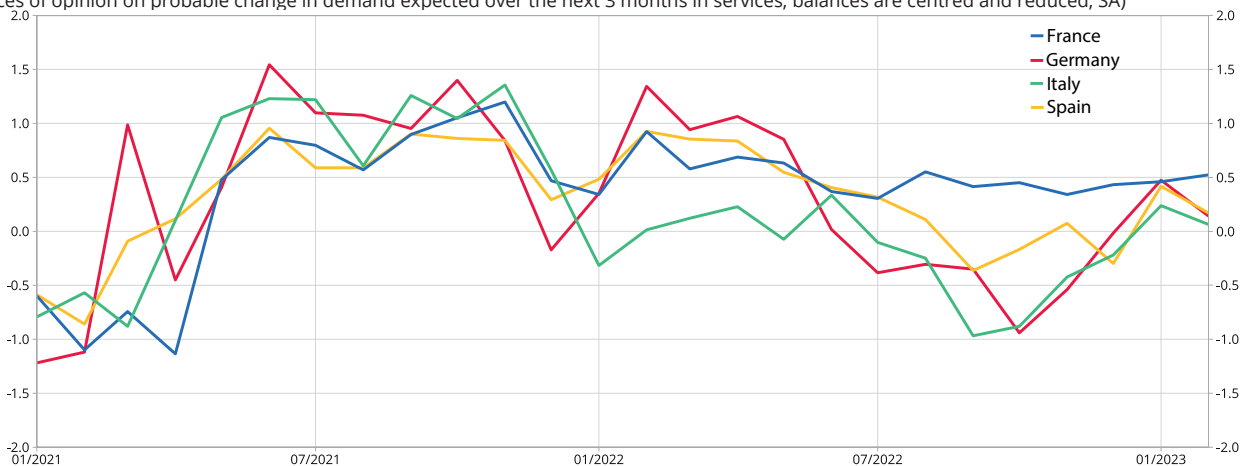
Manufacturing output is still hampered in energy-intensive industries, but in other branches it benefits from a relative easing of supply chain problems

Looking at businesses, the outlook is improving in services but remains more contrasting in industry. In services, business leaders anticipate an increase in demand over the coming months (► **Figure 3**). In Germany, Spain and Italy, the balance of opinion in January exceeded its long-term average for the first time since the summer.

In the manufacturing industry, which is more exposed to higher energy input prices, output continued to decline in the energy-intensive branches in Q4 2022. However, this trend is on a smaller scale than that announced by the industries concerned, and in addition it is offset by the improved performance in other branches, some as a result of the start of the easing of supply chain difficulties (transport equipment, machinery and equipment, ► **Box 2**). All in all, according to the Industrial Production Index, manufacturing output held up at the end of 2022: it increased in Spain (+0.7% in Q4) and France (+0.2%), stagnated in Germany and fell back in Italy (-0.4%). These trends are expected to continue into the beginning of 2023: it is likely that those branches that consume the most energy will continue to be penalised by the increase in the prices of their energy inputs, whereas other branches are expected to benefit both from improved supply chains and relatively full order books. For example, in industries manufacturing other transport equipment, essentially aeronautics, their order books currently guarantee more than 20 months of production in Italy and Spain and more than 10 months in France.

► 3. At the start of 2023, service companies are optimistic overall over prospects for demand

(balances of opinion on probable change in demand expected over the next 3 months in services, balances are centred and reduced, SA)



Note: data are from business tendency surveys of companies. These balances are monthly and correspond to European surveys centralised and harmonised by the DG ECFIN, mainly regarding seasonal adjustment. They have been centred (average of balance between January 2005 and January 2023) and reduced in order to facilitate comparisons between countries.

How to read it: in February 2023, in France, service companies expect a rise in demand in the next three months: the balance of opinion is 0.5, above its long-term average (average of balance between January 2005 and January 2023).

Source: DG ECFIN, INSEE calculations.

International economic outlook

In Q1 2023, the German economy is expected to remain more exposed to high prices, whereas activity is likely to improve moderately in Italy, France and Spain

In Q1 2023, activity is expected to develop in contrasting ways in the main Eurozone economies. It is expected to grow in Spain (+0.4%), to increase more moderately in France (+0.1%) and Italy (+0.2%) and to remain stable in Germany.

In Spain in particular, the fall in energy prices, which in this country quickly impacts on consumer prices, should support household consumption and company production. The country is also still expected to benefit from catch-up effects, as private consumption and especially investment are still below their pre-health crisis level.

In Italy, activity is expected to pick up again after its downturn at the end of 2022. Consumption is likely to rebound slightly, while investment should continue to improve, although slowing a little, since although aid for renovations was extended at the beginning of the year, it was in a less generous form.

In Germany, domestic demand looks set to remain sluggish. Household consumption in particular, is likely to be affected by the decline in purchasing power. However, exports are expected to regain some momentum, mainly as a result of the automobile industry.

In Q2 2023, activity is expected to increase in the main Eurozone economies. The decline in inflation and the buoyancy of wages are likely to contribute to a rebound in private consumption in Germany. Maintaining energy prices at low levels (forecast assumption) and coming out of winter, thus driving back the risk of shortages, would support production in the energy-intensive branches. ●

Box 1: European households substantially reduced their energy consumption in Q4 2022

As well as in France, household energy consumption also fell back at the end of 2022 in the other main Eurozone economies. In Germany, the federal network agency (*Bundesnetzagentur*) estimates¹ that gas consumption by households and small businesses dropped by more than 10% in Q4 2022 compared to the Q4 levels between 2018 and 2021. The decline was even more pronounced than that already observed in Q3 2022.

In an analysis published in December 2022, the Bank of Spain² made a similar observation for the same scope: gas consumption in October and November 2022 would appear to have declined by about 10% compared to the same months in 2019-2021, adjusted for temperatures.

Finally, in Italy, according to data³ from the agency responsible for the Italian electricity network (Terna), consumption by households and non-industrial businesses also appears to have decreased significantly, also after adjustment for the effect of the weather. ●

1 https://www.bundesnetzagentur.de/DE/Gasversorgung/aktuelle_gasversorgung/start.html#SVG.

2 <https://www.bde.es/f/webbde/SES/Secciones/Publicaciones/InformesBoletinesRevistas/BoletinEconomico/22/T4/Files/be2204-it-Box4.pdf>.

3 <https://www.terna.it/en/electric-system/publications/monthly-report>.

Box 2: in Q4 2022, the resistance of manufacturing output in the Eurozone masked some major sectoral disparities

At the end of 2022, in a context of tensions over energy prices, manufacturing output in the main Eurozone economies resisted relatively well overall, however, this masked some contrasting trends in different branches. Output in energy-intensive branches declined in Germany in particular, and more moderately in Italy. In contrast, the pharmaceutical and machinery and equipment branches drove production in the manufacturing industry.

In the main Eurozone economies, manufacturing output held up at the end 2022

At the end of summer 2022, the manufacturing industry in the Eurozone was faced with tensions over volumes and energy prices. These pressures were in addition to difficulties surrounding supply chains, which were certainly in decline, but had been present since the post-covid recovery, as had continuing difficulties with hiring.

However, manufacturing output held up relatively well in Q4 2022: it recorded a slight decline in Italy (-0.4% for the industrial production index on average in Q4, compared to Q3, ► **Figure 1**), stability in Germany and even a slight upturn in France (+0.2%) and Spain (+0.7%). Nevertheless, in each country these trends mask disparities between branches.

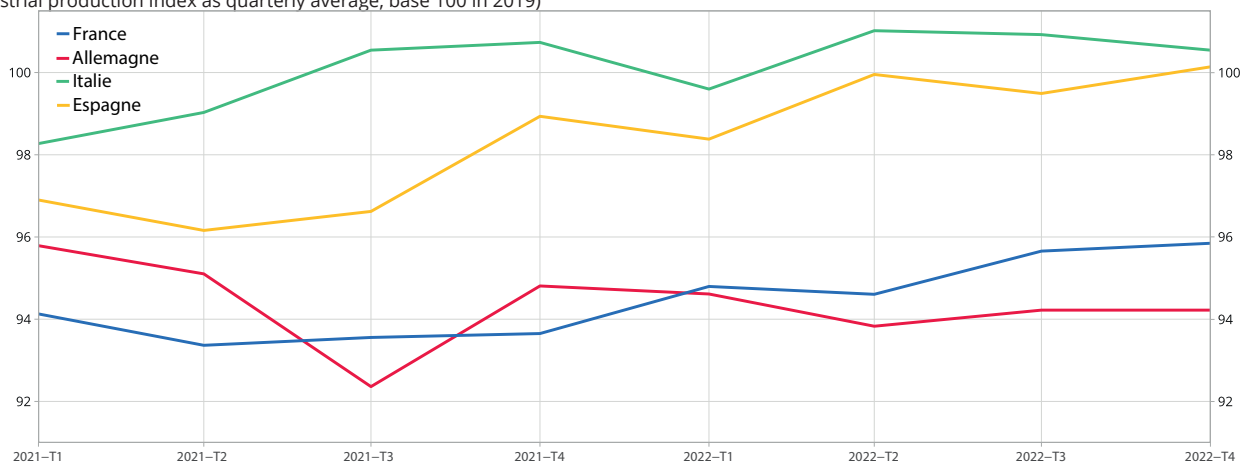
Production in the energy-intensive branches declined overall, as in the previous quarter

Energy-intensive branches represented between 15 and 20% of value added in the manufacturing industry before the Covid-19 pandemic. This study looks at branches whose intermediate consumptions of products that derive from the extractive industries, e.g. the production of coke and refined petroleum and the production and distribution of electricity, gas and air conditioning, represent more than 5% of their value added: paper and paperboard industry, chemical industry, manufacture of other non-metallic mineral products and metallurgy. Production in these branches was particularly exposed to the energy crisis, and their output declined significantly in Q4 (► **Figure 2**).

In Germany in Q4 2022, the fall in output was more pronounced than in France, Italy or Spain, especially in the chemical industry (-11.5%) and the paper and paperboard industry (-7.3%, down for the fourth consecutive quarter). In France and Spain, output declined in a more measured way (drop of 4.2% at most in France, for the chemical industry and -3.1% at most in Spain, for the paper and paperboard industry). In Italy, the drop in output was less, not exceeding 3% over the quarter (metallurgy); the chemical industry even stood out with a slight increase in output (+0.5%), although this did follow a strong contraction in the previous quarter (-6.9%).

► 1. In Q4 2022, manufacturing output held up in the main Eurozone economies

(industrial production index as quarterly average, base 100 in 2019)



Last point: Q4 2022.

How to read it: in Q4 2022, in Italy, manufacturing output was 0.5% above its 2019 average (data adjusted for seasonal variations and working days).

Scope: manufacturing industry.

Source: Insee, Destatis, Istat, INE.

International economic outlook

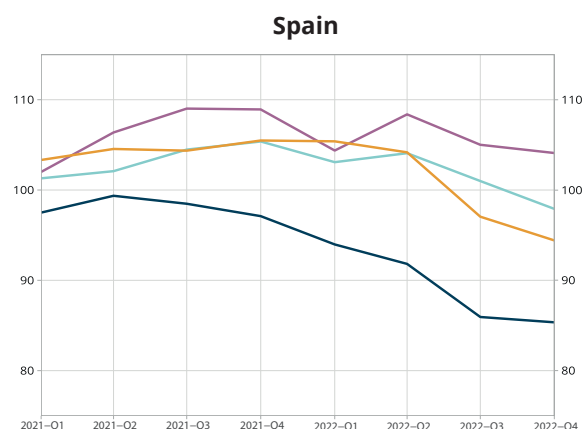
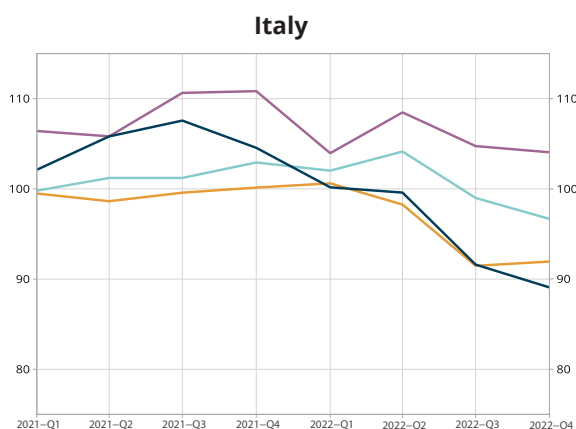
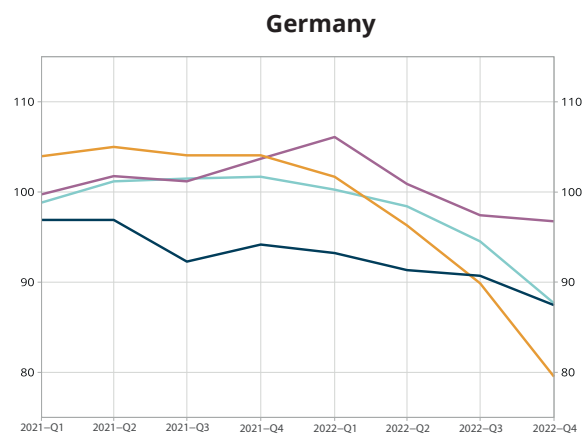
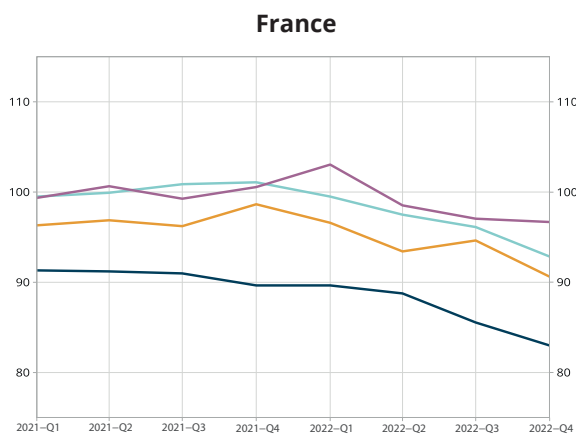
Conversely, some branches benefited from a relative easing of supply chain difficulties

In contrast to the energy-intensive industries, some branches sustained manufacturing output at the end of 2022. This was the case for the manufacture of transport equipment: in this branch, output remains well below its pre-health crisis level (except in Italy) and is therefore still benefiting from catch-up effects. This is particularly the case for the automobile industry: output increased considerably in Germany at the end of 2022 (+9.2% over the quarter), and given the weight of this branch (almost 20% of value added for the manufacturing industry in 2019) it contributed significantly to sustaining German manufacturing output. In France, production also increased considerably in the manufacture of “other transport equipment” (which mainly covers the aeronautical industry), because there was less tension over supply chain difficulties since summer 2022.

With the exception of Germany, production rose overall in the manufacture of electrical equipment and of machinery and equipment. Finally, in the four main Eurozone economies, the pharmaceutical industry was particularly dynamic in Q4. This branch is strong in exports and probably benefited from exchange rate effects and perhaps also from the context of the epidemic at the end of 2022. In France, where the pharmaceutical industry accounts for 7% of value added in manufacturing, the sharp rise in output (+6.4% in Q4) significantly supported manufacturing production as a whole. ●

► 2. In Q4 2022, output declined in the energy-intensive industrial branches

(industrial production index as quarterly average, base 100 in 2019)



— Chemical industry — Metallurgy — Paper and cardboard industry — Manufacture of other non-metallic mineral products

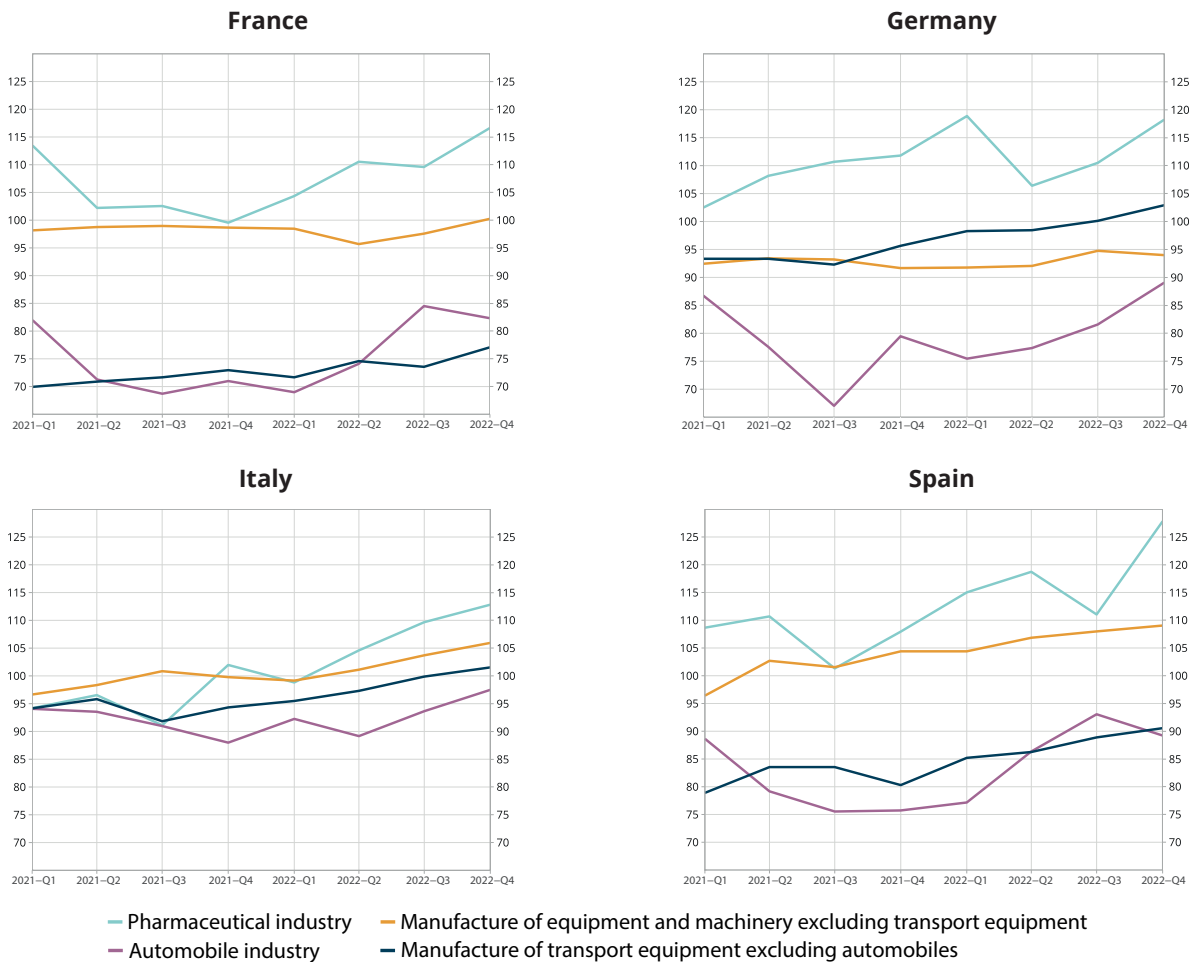
Last point: Q4 2022.

How to read it: in Q4 2022, in Italy, output in metallurgy was 11.0% below its 2019 average (data adjusted for seasonal variations and working days).

Source: Insee, Destatis, Istat, INE.

► 3. In Q4 2022, German and Italian automobile output increased, benefitting from potential catch-up effects

(industrial production index as quarterly average, base 100 in 2019)



Last point: Q4 2022.

How to read it: in Q4 2022, in Italy, output in the automobile industry was 2.5% below its 2019 average (data adjusted for seasonal variations and working days).

Source: INSEE, Destatis, Istat, INE.