Europe benefits from a relatively mild winter

For the first time in many months, the outlook for the European economy has begun to improve. This shift in sentiment partly offsets the certain negative overreaction we witnessed last summer, when it was feared that the increased demand for gas for heating in winter could lead to some form of energy rationing for industry in order to prevent a depletion of reserves before the spring. However, on this occasion the weather has played in our favour: the winter is proving milder than usual and is keeping gas consumption contained (in 2022, it was 15% lower than the average consumption of the previous two years, according to Bruegel), and this is easing the pressure on prices and allowing gas reserves to remain close to the highs for this time of year (around 80%). This factor, together with the measures taken to combat the energy crisis (focused, above all, on promoting energy savings), have substantially modified our energy outlook and we now consider it feasible for oil and, above all, gas prices to remain well below the levels we feared a few months ago (see the Focus «Energy: with 2022 behind us, will 2023 be as turbulent?» in this same report).

What seems clear is that, even if there were a cold snap in the coming weeks, it is now unlikely that we will have to endure energy rationing in the short term, and this dilutes the more pessimistic scenarios we were considering a few months ago. In addition, many of the indicators for both economic activity and demand have shown a more favourable performance than expected in recent months. This improvement in the outlook for the euro area is not incompatible with the behaviour shown by GDP in Q4 2022. The region grew by 0.1% quarter-on-quarter, although this was largely thanks to the surprising growth of Ireland (3.5% quarter-on-quarter), since neither Germany (–0.2%) nor Italy (–0.1%) managed to avoid contraction and France practically stagnated (0.1%).

In fact, the decline suffered by Germany dampens the optimism shown by various official institutions at the start of the year when they declared that the country will have avoided a contraction in Q4. However, the decline in Q4 has been less pronounced than had been expected a few months ago and we should also bear in mind that the figure is preliminary, meaning that it could still be subject to revisions. Moreover, the recovery in the main business confidence indicators suggests that the beginning of 2023 may not be as gloomy as had been anticipated at the end of last summer. Indeed, this is a hypothesis backed up by the Bundesbank's weekly economic activity indicator, which is showing timid signs of improvement in the early stages of this year, albeit within a context of clear weakness. In this regard, the German government's own estimates place growth for 2023 as high as 0.2%, in contrast to the 0.4% recession estimated last autumn. As a result, it seems that the deterioration in economic activity in Q1 2023 will be less pronounced than we had feared last summer. This explains the upward revision of our forecasts for GDP growth in 2023, up to 0.0%, compared to a recession of 0.2% estimated a few months ago.

Italy has also performed much better than expected despite the setback at the end of the year, achieving the best economic performance in the region during 2022, and this trend could well continue according to the main industrial climate indicators. Indeed, the ESI recorded a substantial improvement during the course of Q4 and in December reached values of 100.3, compared to 95.8 in the euro area, 94.6 in Germany and 93.3 in France. In the case of France, *a priori* one of the economies least

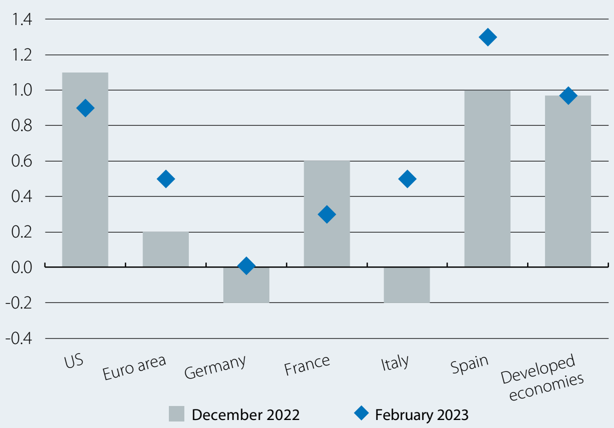
Economic Surprise Index *

Level

Notes: ** Defined as the historical weighted deviations from the differences between the actual published data and analysts' expectations. A positive value means that the published data has been better than expected; if it is negative, this indicates that the actual data was disappointing relative to expectations.*
Source: *CaixaBank Research, based on data from Citigroup and Refinitiv.*

Global: 2023 GDP forecasts

Annual change (%)



Source: *CaixaBank Research, based on data from internal forecasts.*

exposed to Russian gas, its growth has fallen somewhat short of our expectations, largely because it has had to deal with electricity generation issues in a network that is highly dependent on nuclear power plants with maintenance problems. So much so that almost 40% of its nuclear reactors have suffered service interruptions, which has led to electricity generation in France falling to its lowest in seven years and has forced the country to be a net importer of energy.

In short, we have applied upward revisions to growth in 2023 across most of the major countries:[1] +0.2 pps in Germany, up to 0.0%; +0.7 pps in Italy, up to 0.5%; offsetting the –0.3 pps in France, down to 0.3%; hence we revise upwards our growth forecast for the euro area by 0.3 pps, to 0.5%. For 2024, we keep the current scenario virtually unchanged.

On the other hand, parallel to this improved performance in recent months and the outlook with which economic activity has begun 2023, the headwinds for the second half of the year have also gained some strength. The last month has seen a significant heightening of expectations regarding a potential tightening of monetary policy on the part of the ECB, due to the greater persistence in inflation which the central bank is anticipating. In fact, our interest rate forecast scenario has been revised upwards and we now think the ECB's benchmark rate could reach 3.5% by mid-year.

In this context of improved economic outlook, inflation has begun to show timid signs of moderation, although it is still very high (9.2% in December). During the course of 2023, the decline in headline inflation will intensify thanks to the stabilisation of energy prices, the normalisation of the bottlenecks and the economic slowdown (see the Dossier in this same report). As such, it could fall to slightly below 4% by the end of 2023, although second-round effects and the withdrawal of the various fiscal measures implemented to offset the rising energy prices are likely to continue to have considerable inertia, resulting in the 2% target rate not being reached until late 2024.

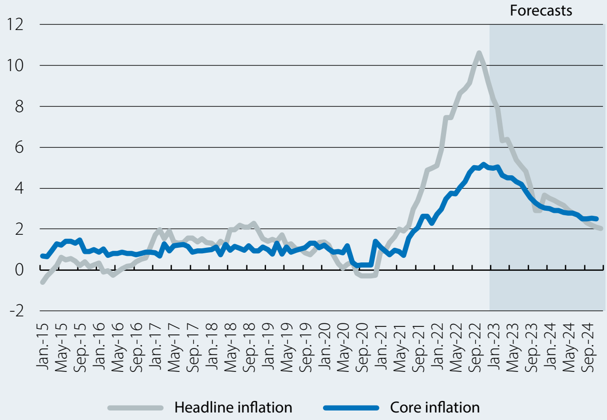
This better performance of the European economy contrasts with the evidence of a greater cooling than expected in the US economy at the end of 2022 and in early 2023, which has led to a downward revision of the growth forecast for the US, although we remain confident that it will avoid a recession (see the Focus «US: land as best you can» in this *Monthly Report*).

However, it must be borne in mind that, although expectations for the European economy have improved, our forecast scenario is still one of almost stagnation

1. For Spain, we revised growth for 2023 up by 0.3 pps, to 1.3% (see the Focus «The outlook for the Spanish economy improves» in this same report).

Euro area: headline and core inflation

Year-on-year change (%)



Source: *CaixaBank Research, based on data from Eurostat and internal forecasts.*

and uncertainty remains very high. The war in Ukraine is showing no sign of ending in the short term and the end of China's zero-COVID policy will affect the global economy. Indeed, the reopening of the Chinese economy is a double-edged sword for developed economies. On the one hand, it is quite likely that there will be a notable rebound in economic activity in the spring (once the first waves of contagion after the reopening process have been overcome) and that global supply chains will be stimulated. On the other hand, however, this revival will exert clear pressure on the demand for many industrial commodities, including oil and gas, and this will push up their prices. Moreover, our scenario contemplates a clear acceleration in China's economy in the second half of 2023, coinciding with the period in which Europe will once again need to replenish its gas reserves ahead of the 2023-2024 winter in a scenario in which, *a priori*, the supply of Russian gas to Europe will remain almost nil. When the time comes, the «winter» variable will once again be key for elaborating forecast scenarios. In short, although the worst scenarios have dissipated in the short term, it is still too early to declare victory in a year that will continue to be marked by high uncertainty and complexity.

Rita Sánchez Soliva