Economic perspectives

UBB
Part of KBC Group

August 2023

Highlights

- Well-filled EU gas reserves (filled at 88% of total capacity) have brought gas prices down to 26.8 EUR/ MWh in July, 27% lower than in June and 87% lower than a year ago. A month earlier, European gas prices faced upward pressure due to an extended maintenance on Norwegian gas infrastructure and the permanent closure of the Groningen gas field. Prices again surged above 40 EUR/ MWh in recent days due to potential strikes in Australian LNG plants. Meanwhile, oil prices increased by 13.5% to 85 USD per barrel in July. A resilient US economy and a strong Indian economy have driven up global demand. At the same time, Saudi Arabia announced it would extend its 1 million barrels supply cut and suggested it could even deepen oil production cuts in the future. The country's oil supply is now 3 million barrels lower than the maximum capacity. Global food prices also increased slightly in July (+1.2%). The Russian abandonment of the Black Sea grain deal and its bombing of Ukraine's port infrastructure drove up wheat and vegetable oil prices. Meanwhile, a new Indian rice export ban drove up rice prices on world markets. These increases were partly compensated by decreases in sugar and maize prices, which benefited from successful harvests.

- In the euro area, inflation fell to 5.3% in July, down from 5.5% in June. As in previous months, the decline was driven solely by the fall in energy prices and cooling food price inflation. Core inflation stabilised at 5.5%. The marked slowdown in goods inflation excluding energy (from 6.8% in February 2023 to 5.0% in July), is currently still counterbalanced by rising services inflation (from 4.4% in January 2023 to 5.6% in July). Base effects will almost certainly push inflation down further in the coming months. But due to the still tight labour market and the (partial) catch-up of wages to inflation, services inflation will cool only very gradually. This is the main reason why inflation is expected to remain significantly higher than the ECB's 2% target for a long time to come. For the eurozone, we expect average inflation to be 5.6% in 2023 and 2.9% in 2024.

- In the US, inflation increased from 3% to 3.2% in July, while core inflation decreased from 4.8% to 4.7%. The headline increase was a result of base effects as month-on-month inflation was exceptionally low in July 2022. This year, inflation rose by 0.17% month-on-month in July. The inflation figure was primarily driven by shelter prices, which grew by 0.44%. Food and energy prices increased marginally (by 0.2% and 0.1% respectively). Goods prices declined by 0.3%, thanks to lower used car prices and easing global supply chains. Services (ex-shelter and energy services) increased by only 0.2%, despite continued high wage pressure. For the coming months, rising food and energy prices will likely put upward pressure on headline inflation while core inflation is likely to ease further thanks to declining used car prices and softening shelter inflation (forward-looking indicators for both items are encouraging). We now expect US inflation to reach 3.9% in 2023 and 2.2% in 2024.

- Both the Fed and the ECB are in the final phase of their tightening cycles. Following the July monetary policy meetings, we still expect one final rate hike by the ECB, while the Fed likely already reached its peak rate. Both central banks are expected to maintain rates at their peak levels well into 2024. As inflation normalises, largely due to base effects, we expect the rate cutting cycle to start for the Fed in Q2 2024, followed by the ECB later in 2024. The shrinking of the Fed and ECB balance sheets is expected to continue. For now, the ECB maintains its tools to stabilise intra-EMU bond markets (flexible reinvestments of the maturing assets of its PEPP portfolio and potential interventions via the Transmission Protection Instrument). Most 10-year government bond yields are currently near their peaks. The expected easing in the course of 2024 by the Fed and the ECB will lead to a gradual reversal of the currently strongly inverted yield curves, with short-term rates falling more than long-term bond yields.

- In the euro area, according to Eurostat's preliminary flash estimate, real GDP increased by 0.3% quarter-on-quarter in the second quarter of 2023. Against the backdrop of confidence losses in recent months, this is better than expected. The German economy stagnated. While there is still no sign of a recovery after the previous two quarters of negative growth, revised historical figures suggest that the recession was slightly less deep than initially estimated. Tighter monetary policy, more restrictive fiscal policy and the imminent US slowdown will continue to weigh on economic activity in the second half of 2023. As a result, we expect euro area real GDP growth to average 0.6% in 2023. In 2024, strengthening private consumption and investment will gradually strengthen growth to 0.9% on average.

- In the US, the economy grew by 0.6% quarter-on-quarter in Q2, on the back of strong fixed investment and resilient consumption, which rebounded in June. Contrary to the previous quarter, inventories grew while net exports made a negative contribution. Productivity rebounded in Q2 as it rose by 0.9% quarter-on-quarter. Looking ahead, growth will likely slow down significantly from Q3 onwards. A first sign of weakening came from the latest labour market report. Non-farm payrolls increased by only 187k in July and there were 49k of downward revisions in prior months. Average hours ticked back down to 34.3 hours per week, an indication of increased labour hoarding. Forward-looking indicators also provided a concerning picture. In the service sector, business sentiment indicators declined significantly in July. For the manufacturing sector, sentiment indicators recovered, but remained in recessionary territory. Consumer confidence indicators also rebounded, but to still low levels. Surveys of loan officers also pointed to further tightening of lending requirements. Furthermore, consumption could weaken by the end of the year as excess saving buffers built-up during the pandemic are wound down and student loan repayments will resume in October. Though we still expect a strong 1.8% growth in 2023, we forecast growth to slow down to 0.6% in 2024.

- In China, the economy grew by a relatively meager (for China) 0.8% in the second quarter of 2023. Together with weak leading indicators early in the third quarter, this figure confirms the picture of a weak and short-lived post-covid recovery with growth below potential. Consequently, pressure is mounting on the government to crank up the economy. At its quarterly meeting in July, the government indicated its willingness to provide additional support for growth but few details were given on what this support would look like. Unlike in past decades, monetary and fiscal policy actions in recent months have been remarkably piecemeal and targeted. The government's cautious approach makes sense as opening the policy floodgates now could have significant costs to the economy. On the monetary policy side, there is the problem of interest rate differentials with other major economies (which are in a tightening cycle) and its effect on international investment in China. Significant policy easing would likely put further pressure on the currency. In addition, because of growing concerns about local government debt and the real estate crisis, it is also difficult to apply the usual policy interventions on the fiscal side. We therefore assume that while the government will stimulate the economy, the measures will not be of the same magnitude as in the past. This, combined with the disappointing second quarter and continued weakness in leading indicators, led us to revise our GDP growth forecast downward to 5.1% for 2023 and 4.5% for 2024.

- In Belgium, quarter-on-quarter GDP growth slowed to 0.2% in the second quarter of 2023, from 0.4% in the first, according the flash estimate. Value added was down again in industry (-1.0%), but rose in services (+0.5%) and construction (+0.1%). The less upbeat growth figure was in line with the recent development of business confidence, which fell for the fourth consecutive month in July. Following the turning sentiment and weak industrial climate, we see quarter-on-quarter growth in Q3 and Q4 slowing further to just 0.1%, resulting in a growth rate of 0.9% for the full year 2023. Belgian HICP inflation was stable at 1.6% in July, the lowest figure in the EU. Core inflation (excluding energy and food) declined from 6.5% to 6.1%, still well above the EU average. Base effects will push headline inflation down further in the coming months. After the rapid decline throughout 2023, we expect Belgian inflation to temporarily pick up again in the first half of 2024, as energy inflation turns positive again due to the technical impact of the unwinding of energy support measures and diminishing base effects.

- In the CEE-region, the Czech National Bank (CNB) left interest rates unchanged but surprised a significant part of the market by formally ending the intervention regime announced in May 2022. The koruna initially weakened by more than 1% against the euro in response to the announcement. While the currency pair may stabilise after short-term losses, the CNB decision to remove the "guarantee" will make the koruna more vulnerable to any foreign shocks and to the dynamics of neighbouring central European currencies going forward. The CNB's new forecast also brought a downward revision of the GDP and inflation outlook, not only for 2023 but also for 2024. In the baseline scenario, the CNB now has similar growth rates to ours, but much lower inflation in 2024 (2.1% versus our estimate of 2.6%). The relatively optimistic "baseline" medium-term outlook for inflation is probably the reason why the Board now sees the risks to the forecast as clearly "pro-inflation".

- Contrary to the CNB, the Hungarian central bank (MNB) cut the collateralised lending rate by 100 bps to 17.5%, but left the deposit rate and base rate unchanged. The MNB expects the economy to slow down to 0-1.5% this year (we forecast 0%), as declining real wages and rising corporate costs hinder growth. In 2024, the MNB sees growth accelerating to 3.5-4.5% (we forecast 3.7%). The central banks expects inflation to decrease further at a rapid pace because of tight monetary policy, falling global commodity prices and declining domestic consumption. It projects yearly CPI to be at 16.5-18.5% for 2023 (we forecast 17.4%) and at 3.5-5.5% for 2024 (we forecast 6%).

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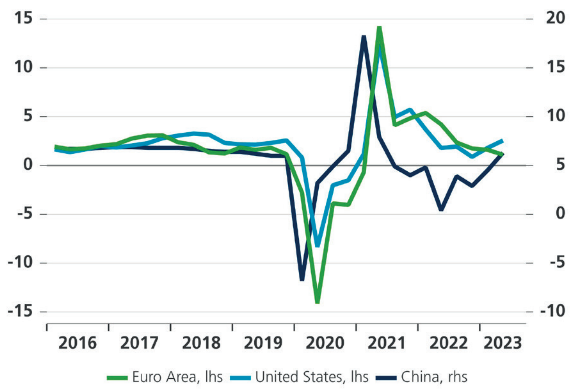
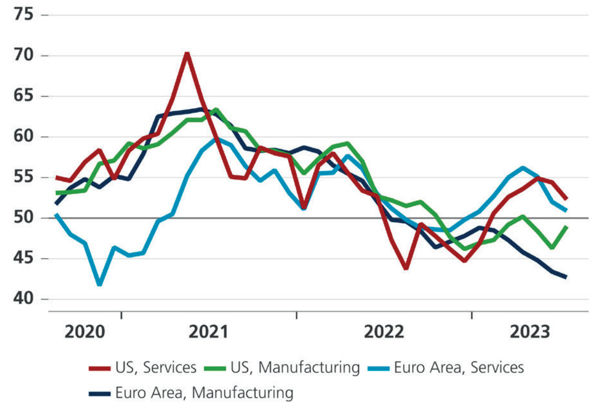
Figures

Real GDP
yearly change in %



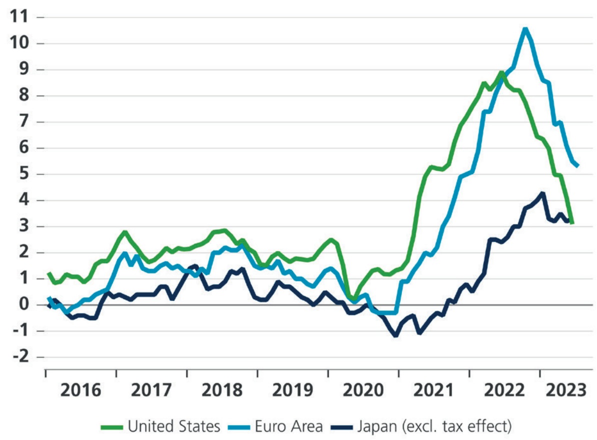
Source: KBC Economics based on Eurostat, BEA, NBS

Business confidence indicators
index, above 50 = expansion



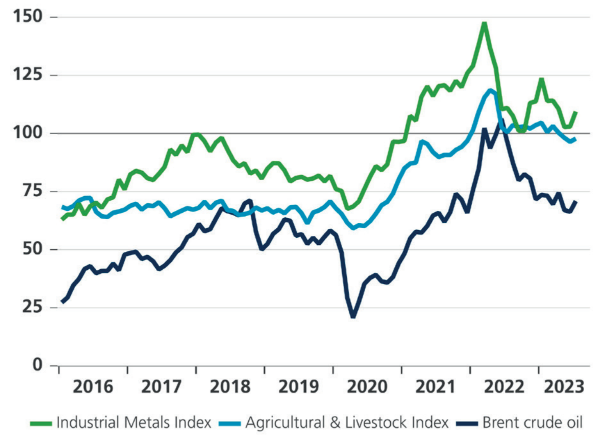
Source: KBC Economics based on S&P Global

Headline inflation
yearly change consumer price index, in %



Source: KBC Economics based on Eurostat. SBJ. BLS

Commodity prices
index, January 2013=100, in USD

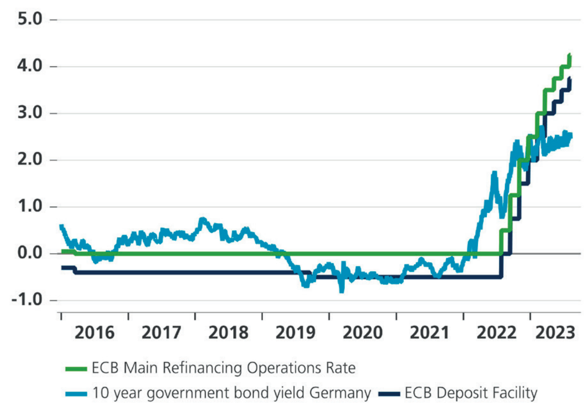


Source: KBC Economics based on World Bank, S&P Global

United States interest rates
in %

Source: KBC Economics based on Fed, U.S. Department of Treasury

Euro area interest rates
in %

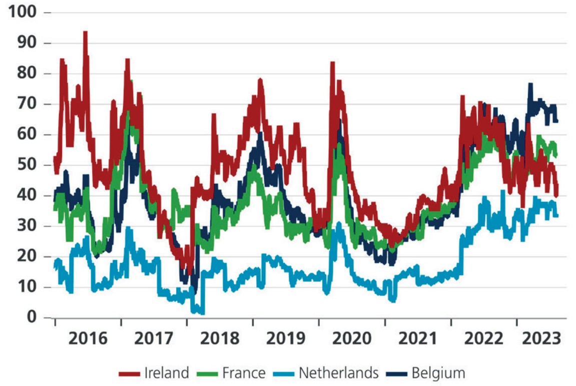


Source: KBC Economics based on Macrobond, ECB

Figures

10 year government bond yield spreads to Germany

in basis points



Source: KBC Economics based on Macrobond

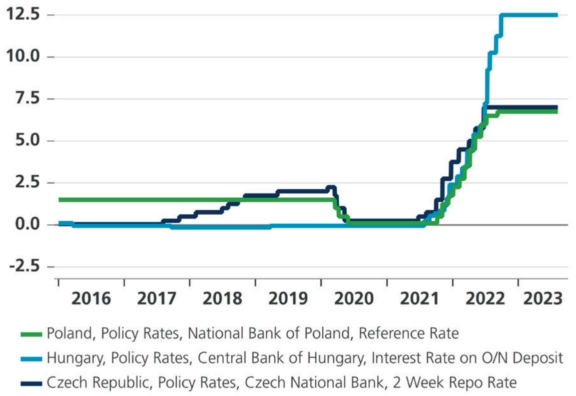
10 year government bond yield spreads to Germany

in basis points

Source: KBC Economics based on Macrobond

Monetary policy rates Central Europe

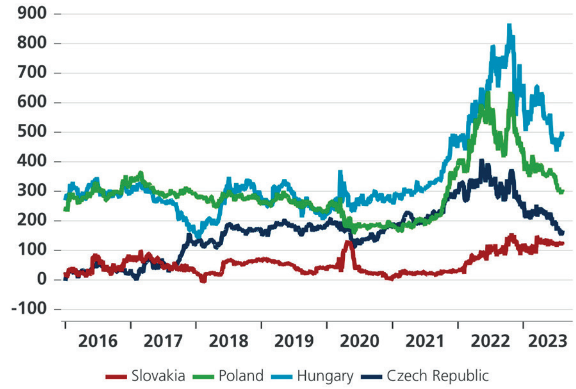
in %



Source: KBC Economics based on CNB, MNB, NBP

10 year government bond yield spreads to Germany

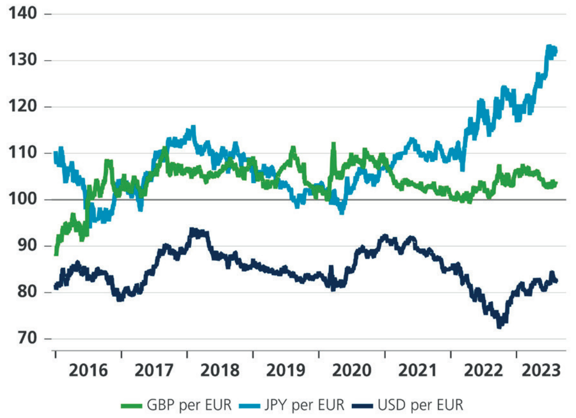
in basis points



Source: KBC Economics based on Macrobond, AKK, Eurostat

Exchange rates

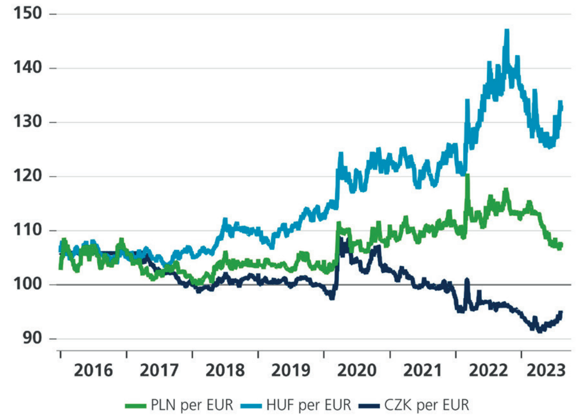
index, January 2013=100, increase = stronger EUR



Source: KBC Economics based on Macrobond

Exchange rates

index, January 2013=100, increase = stronger EUR



Source: KBC Economics based on Macrobond

Outlook main economies in the world

		Real GDP growth (period average, based on quarterly figures, in %)			Inflation (period average, in %)		
		2022	2023	2024	2022	2023	2024
Euro area	Euro area	3.4	0.6	0.9	8.4	5.6	2.9
	Germany	1.9	-0.2	0.5	8.7	6.2	3.0
	France	2.5	0.9	1.0	5.9	5.8	2.3
	Italy	3.8	0.8	0.6	8.8	6.2	2.1
	Spain	5.5	2.2	1.6	8.3	3.3	3.4
	Netherlands	4.4	0.8	1.0	11.6	4.4	3.6
	Belgium	3.2	0.9	1.0	10.3	2.5	3.2
	Ireland	12.0	5.6	4.8	8.1	5.0	3.2
	Slovakia	1.7	1.2	2.2	12.1	10.8	5.9
Central and Eastern Europe	Czech Republic	2.4	0.0	2.7	14.8	10.7	2.6
	Hungary	4.6	0.0	3.7	15.3	17.4	6.0
	Bulgaria	3.7	1.8	2.3	13.0	9.0	5.0
	Poland	5.4	1.7	4.4	13.2	12.2	3.5
	Romania	4.2	2.5	3.2	12.0	9.0	7.0
Rest of Europe	United Kingdom	4.1	0.1	0.8	9.3	7.3	3.2
	Sweden	2.9	-0.4	0.7	8.1	8.4	2.9
	Norway (mainland)	3.7	1.3	1.2	6.2	5.6	3.1
	Switzerland	2.1	0.8	1.4	2.8	2.3	1.5
Emerging markets	China	3.0	5.1	4.5	2.0	0.8	2.1
	India*	7.2	6.0	6.3	6.7	5.1	4.7
	South Africa	1.9	0.0	1.3	7.0	5.9	4.9
	Russia	Temporarily no forecast due to extreme uncertainty					
	Turkey	5.6	2.4	2.2	72.3	43.4	33.2
	Brazil	2.9	2.7	0.9	9.3	5.0	4.4
Other advanced economies	United States	2.1	1.8	0.6	8.0	3.9	2.2
	Japan	1.0	1.1	1.0	2.5	2.9	1.7
	Australia	3.7	1.5	1.4	6.6	5.7	3.2
	New Zealand	2.3	0.7	1.0	7.2	5.3	2.9
	Canada	3.4	1.4	0.9	7.0	3.7	2.3
*** fiscal year from April-March**						8/08/2023	

Policy rates (end of period, in %)		8/8/2023	Q3 2023	Q4 2023	Q1 2024	Q2 2024
Euro area	Euro area (refi rate)	4.25	4.50	4.50	4.50	4.50
	Euro area (depo rate)	3.75	4.00	4.00	4.00	4.00
Central and Eastern Europe	Czech Republic	7.00	7.00	6.50	5.50	5.00
	Hungary (BUBOR 3M)	14.19	12.50	10.80	9.50	8.00
	Bulgaria	-				
	Poland	6.75	6.75	6.75	6.25	5.75
	Romania	7.00	7.25	7.00	6.50	6.50
Rest of Europe	United Kingdom	5.25	5.50	5.75	5.75	5.75
	Sweden	3.75	4.00	4.25	4.25	4.25
	Norway	3.75	4.25	4.25	4.25	4.25
	Switzerland	1.75	2.00	2.00	2.00	2.00
Emerging markets	China	2.65	2.55	2.55	2.55	2.55
	India	6.50	6.50	6.50	6.25	6.00
	South Africa	8.25	8.25	8.25	8.25	8.00
	Russia	Temporarily no forecast due to extreme uncertainty				
	Turkey	17.50	22.00	25.00	27.50	25.00
	Brazil	13.25	13.25	12.25	11.25	10.25
Other advanced economies	United States (mid-target range)	5.375	5.375	5.375	5.375	5.125
	Japan	-0.10	-0.10	-0.10	-0.10	-0.10
	Australia	4.10	4.35	4.35	4.35	4.35
	New Zealand	5.50	5.50	5.50	5.50	5.50
	Canada	5.00	5.25	5.25	5.25	5.25

Outlook main economies in the world

10 year government bond yields (end of period, in %)						
		8/8/2023	Q3 2023	Q4 2023	Q1 2024	Q2 2024
Euro area	Germany	2.44	2.55	2.50	2.45	2.40
	France	3.00	3.25	3.20	3.15	3.10
	Italy	4.14	4.55	4.50	4.45	4.40
	Spain	3.50	3.75	3.70	3.65	3.60
	Netherlands	2.80	2.95	2.90	2.85	2.80
	Belgium	3.12	3.35	3.30	3.25	3.20
	Ireland	2.86	3.05	3.00	2.95	2.90
	Slovakia	3.72	3.75	3.70	3.65	3.60
Central and Eastern Europe	Czech Republic	4.10	4.30	4.30	4.33	4.25
	Hungary	7.49	7.00	6.50	6.40	6.30
	Bulgaria*	4.50	4.65	4.60	4.55	4.50
	Poland	5.53	5.50	5.40	5.20	4.85
	Romania	6.82	8.00	8.50	8.60	8.60
Rest of Europe	United Kingdom	4.39	4.75	4.65	4.60	4.55
	Sweden	2.61	2.70	2.65	2.55	2.50
	Norway	3.98	3.95	3.90	3.85	3.80
	Switzerland	0.95	1.15	1.10	1.00	0.95
Emerging markets	China	2.65	2.60	2.60	2.45	2.45
	India	7.17	7.10	7.05	6.90	6.80
	South Africa	10.22	10.12	10.07	9.92	9.82
	Russia	11.65	Temporarily no forecast due to extreme uncertainty			
	Turkey	18.11	25.00	25.00	25.00	25.00
	Brazil	10.95	10.15	9.85	9.70	9.60
Other advanced economies	United States	4.00	3.90	3.85	3.70	3.60
	Japan	0.60	0.50	0.50	0.50	0.75
	Australia	3.98	3.90	3.85	3.70	3.60
	New Zealand	4.82	4.65	4.60	4.45	4.35
	Canada	3.47	3.45	3.40	3.25	3.15

***Caution: very illiquid market**

Exchange rates (end of period)					
	8/8/2023	Q3 2023	Q4 2023	Q1 2024	Q2 2024
USD per EUR	1.09	1.12	1.13	1.14	1.15
CZK per EUR	24.27	23.80	23.90	24.00	24.30
HUF per EUR	390	375	385	382	385
PLN per EUR	4.46	4.50	4.45	4.45	4.40
BGN per EUR	1.96	1.96	1.96	1.96	1.96
RON per EUR	4.94	4.95	4.95	4.95	4.95
GBP per EUR	0.86	0.88	0.90	0.91	0.92
SEK per EUR	11.74	11.40	11.25	11.10	11.00
NOK per EUR	11.29	11.25	11.25	11.10	11.00
CHF per EUR	0.96	0.95	1.00	1.02	1.02
BRL per USD	4.92	4.85	4.83	4.81	4.79
INR per USD	82.92	81.8	81.4	81.1	80.7
ZAR per USD	18.98	18.7	18.6	18.6	18.5
RUB per USD	97.05	Temporarily no forecast due to extreme uncertainty			
TRY per USD	27.01	26.46	28.01	28.68	29.34
RMB per USD	7.22	7.18	7.18	7.17	7.15
JPY per USD	143.12	135.00	130.00	128.00	125.00
USD per AUD	0.65	0.66	0.66	0.66	0.67
USD per NZD	0.60	0.62	0.62	0.62	0.63
CAD per USD	1.35	1.33	1.33	1.32	1.31

Outlook KBC home markets

	Belgium			Ireland		
	2022	2023	2024	2022	2023	2024
Real GDP (average yearly change, in %)	3.2	0.9	1.0	12.0	5.6	4.8
Inflation (average yearly change, harmonised CPI, in %)	10.3	2.5	3.2	8.1	5.0	3.2
Unemployment rate (Eurostat definition, in % of the labour force, end of year)	5.7	5.8	5.7	4.4	4.4	4.4
Government budget balance (in % of GDP)	-3.9	-5.0	-4.9	1.6	1.3	1.2
Gross public debt (in % of GDP)	105.1	105.6	106.7	44.7	39.9	36.1
Current account balance (in % of GDP)	-3.6	-2.0	-1.6	9.1	8.2	7.5
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	5.6	1.0	1.5	12.3	2.0	3.0

	Czech Republic			Slovakia		
	2022	2023	2024	2022	2023	2024
Real GDP (average yearly change, in %)	2.4	0.0	2.7	1.7	1.2	2.2
Inflation (average yearly change, harmonised CPI, in %)	14.8	10.7	2.6	12.1	10.8	5.9
Unemployment rate (Eurostat definition) (in % of the labour force, end of year)	2.3	2.8	3.2	6.1	6.1	6.3
Government budget balance (in % of GDP)	-3.6	-4.9	-2.5	-2.0	-6.5	-4.5
Gross public debt (in % of GDP)	44.1	45.0	45.0	57.8	58.5	58.0
Current account balance (in % of GDP)	-6.1	0.1	0.8	-8.1	-4.5	-3.5
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	16.9	-1.0	2.0	13.7	-3.5	0.0

	Hungary			Bulgaria		
	2022	2023	2024	2022	2023	2024
Real GDP (average yearly change, in %)	4.6	0.0	3.7	3.7	1.8	2.3
Inflation (average yearly change, harmonised CPI, in %)	15.3	17.4	6.0	13.0	9.0	5.0
Unemployment rate (Eurostat definition) (in % of the labour force, end of year)	3.8	4.1	3.8	4.0	4.3	4.1
Government budget balance (in % of GDP)	-6.2	-4.8	-3.2	-2.8	-3.0	-3.0
Gross public debt (in % of GDP)	73.3	70.3	68.3	22.9	23.5	24.9
Current account balance (in % of GDP)	-8.0	-1.9	-1.2	-0.7	-1.5	-1.2
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	21.9	-1.0	3.0	13.8	5.0	1.5

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