

REGIONAL ECONOMIC OUTLOOK

EUROPE



EUROPEAN
DEPARTMENT

EUR Regional Economic Outlook

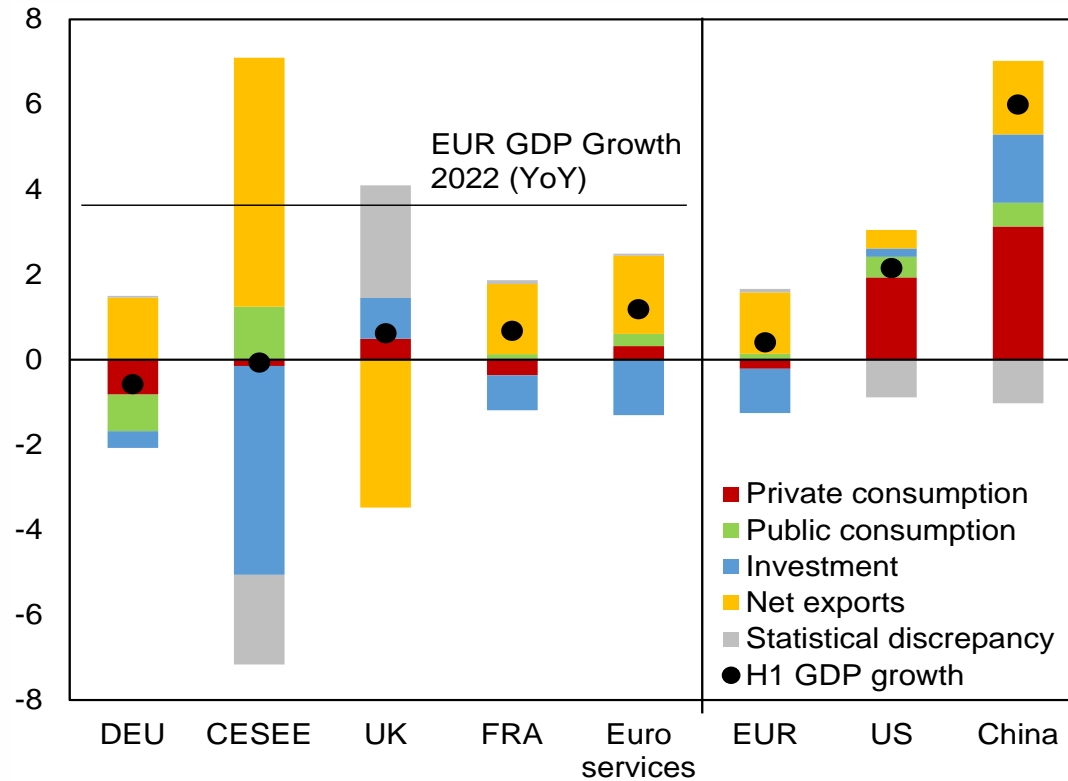
**Restoring Price Stability and
Securing Strong and Green Growth**

NOVEMBER 8, 2023

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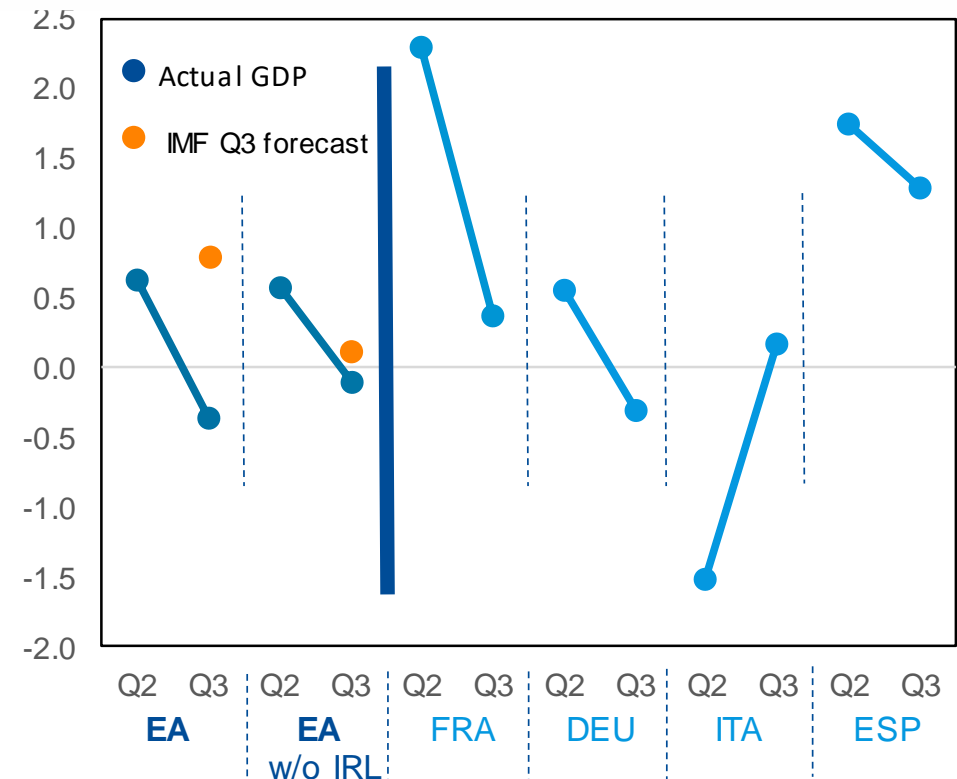
Growth slowdown continues mostly as expected in Q3

Europe: 2023 H1 GDP Growth and Contributors
(Half-yearly annualized growth)



Sources: World Economic Outlook, Haver Analytics and IMF staff calculations.
Note: Euro services refers to service sector intensive countries and includes ESP, GRC, PRT and ITA; CESEE countries include EST, HUN, POL, BGR, ROU, CZE, LVA, LTU.

Euro Area: 2023 Q3 Growth
(Quarterly annualized growth and percentage points)

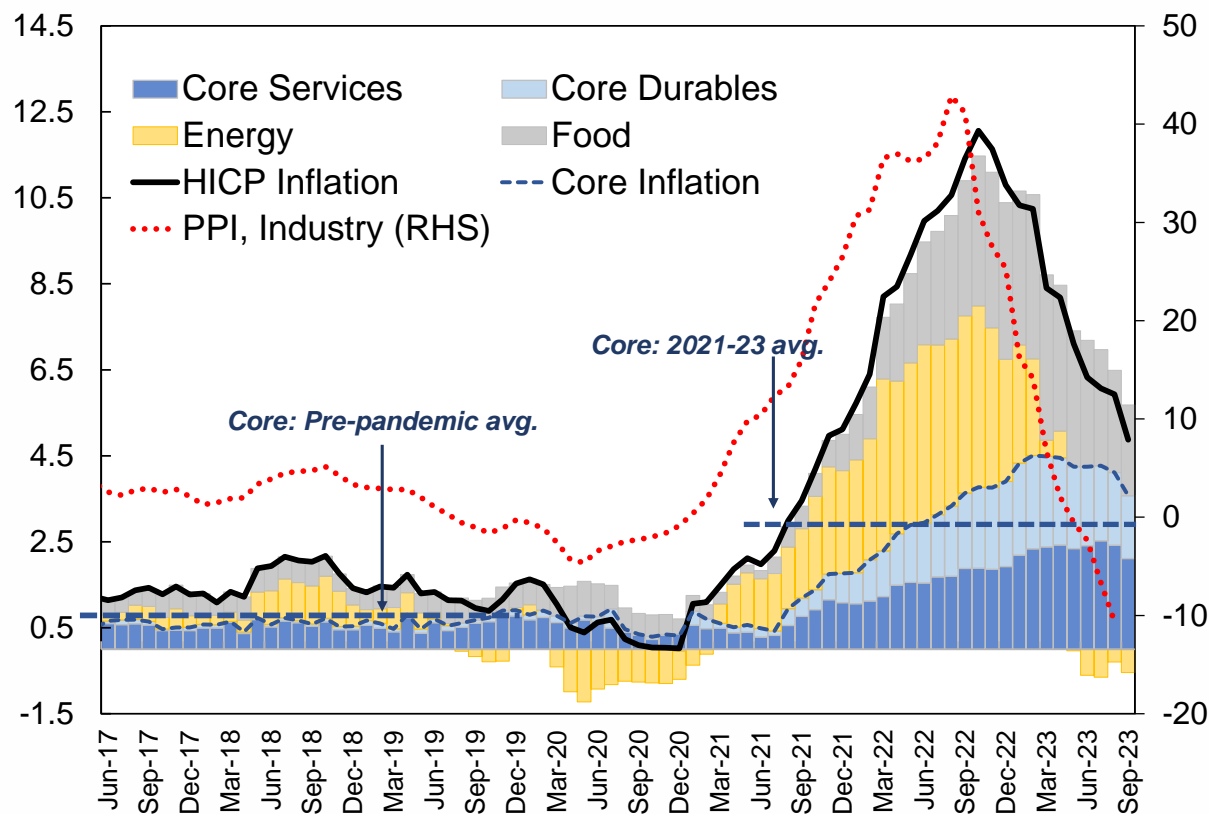


Sources: World Economic Outlook, Eurostat, Haver Analytics and IMF staff calculations. EA is Euro Area.

Headline inflation is dropping but so far limited changes in core

EU27: Inflation Dynamics

(percent contribution and y/y change)

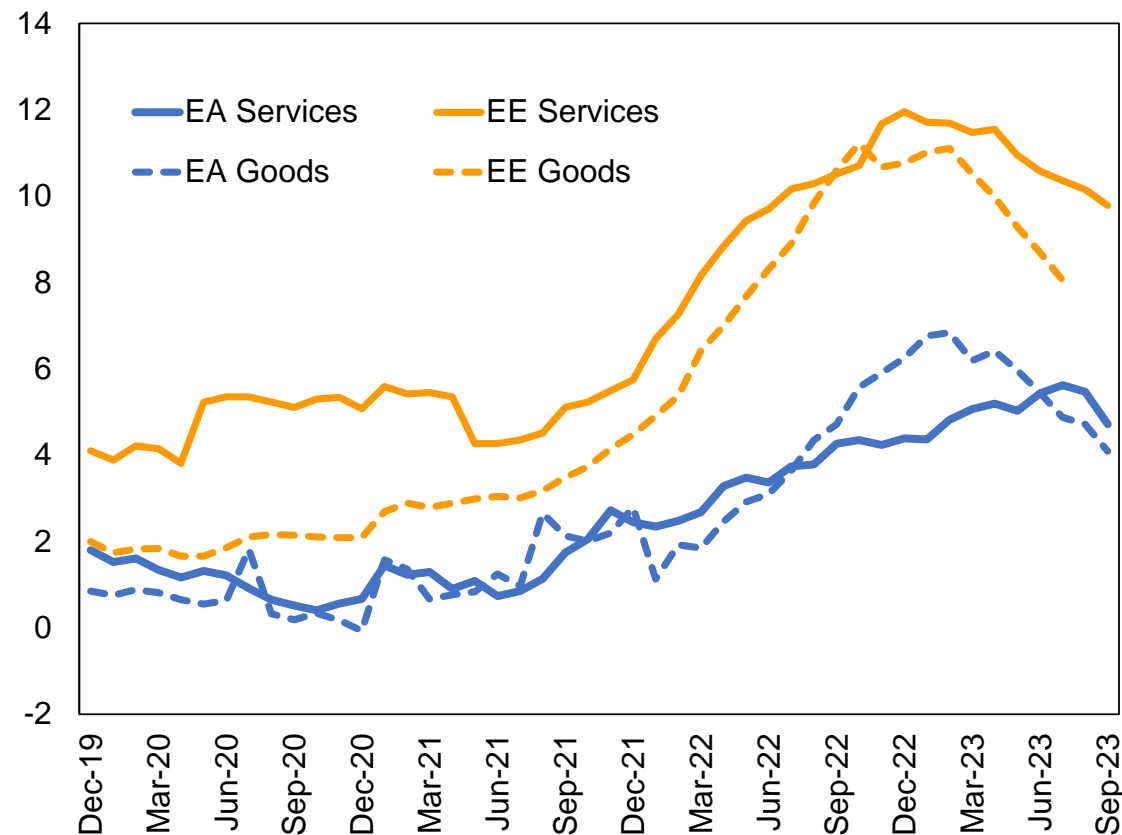


Sources: Eurostat, Haver Analytics and IMF staff calculations.

Note: Constant weights are used to compute the contribution to headline inflation.

Non-energy Goods and Services Inflation

(Percent change, year over year)



Sources: European Commission and IMF staff calculations.

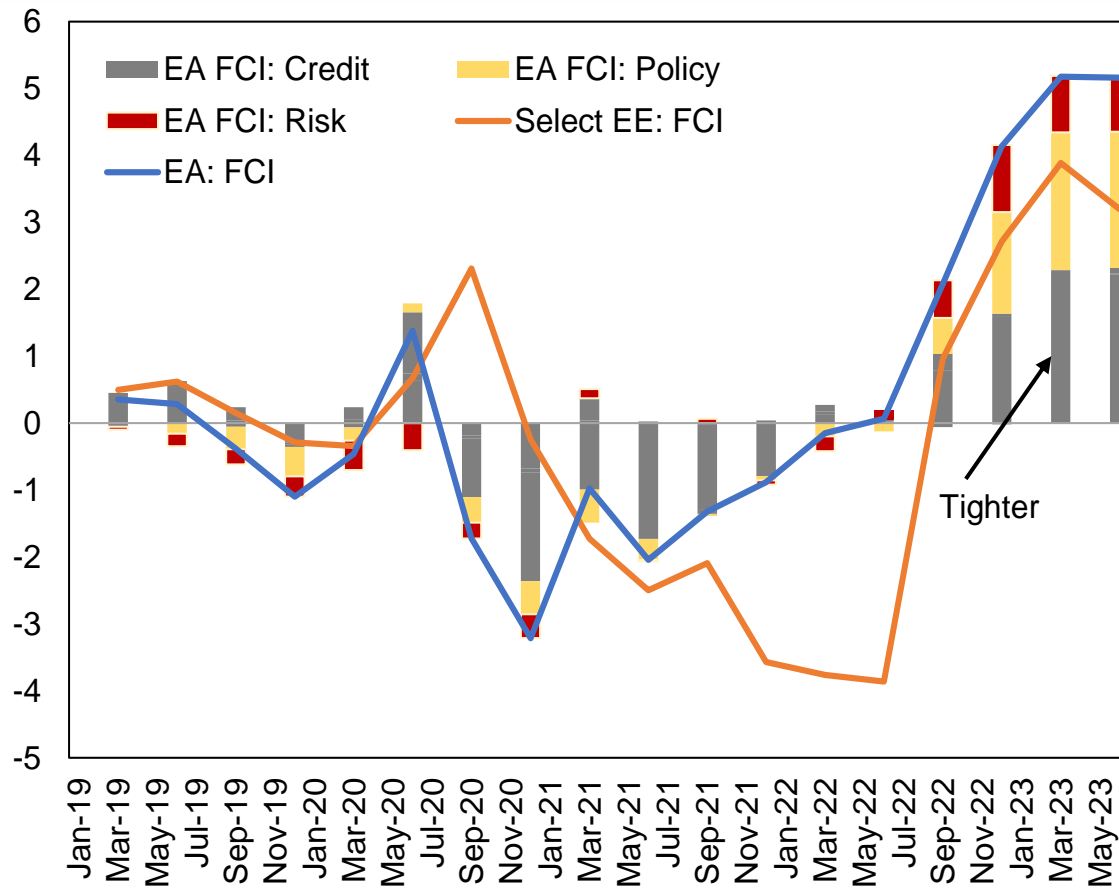
Note: EA= Euro Area, EE = Emerging Market Europe; EE excludes Russia, Turkey and Ukraine.

I. Outlook

Outlook drivers: policy tightening versus recovering real income

Euro Area and Select EE Financial Conditions

(Contribution q/q first difference of Financial Conditions Index)

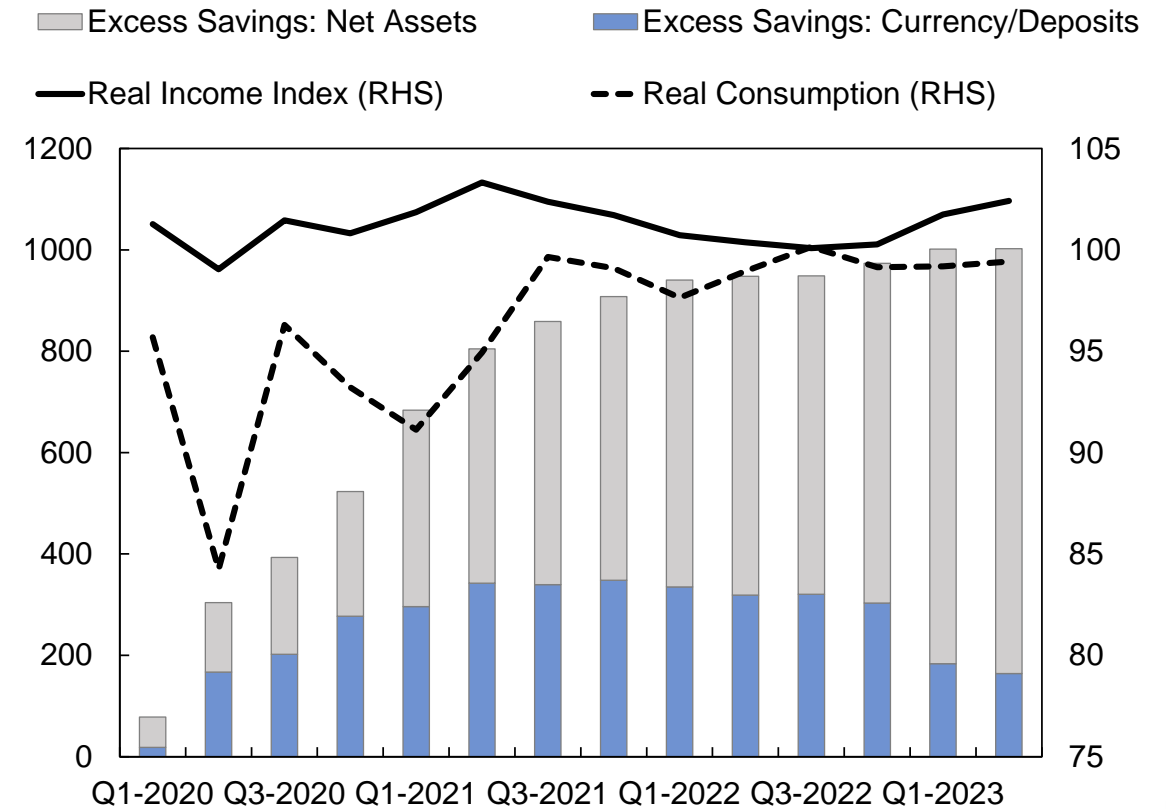


Sources: Haver Analytics, IMF staff calculations, and Guzzo et. al., 2022

Note: AE= Advanced Europe, EE= Emerging Market Europe. FCI refers to financial conditions index; credit availability and costs, external conditions, funding constraints are grouped as FCI: credit. EE FCI is PPP weighted average of Poland, Czech Republic and Hungary.

Euro Area: Excess savings and Real Incomes

(EUR billion and index with 2019Q4=100)



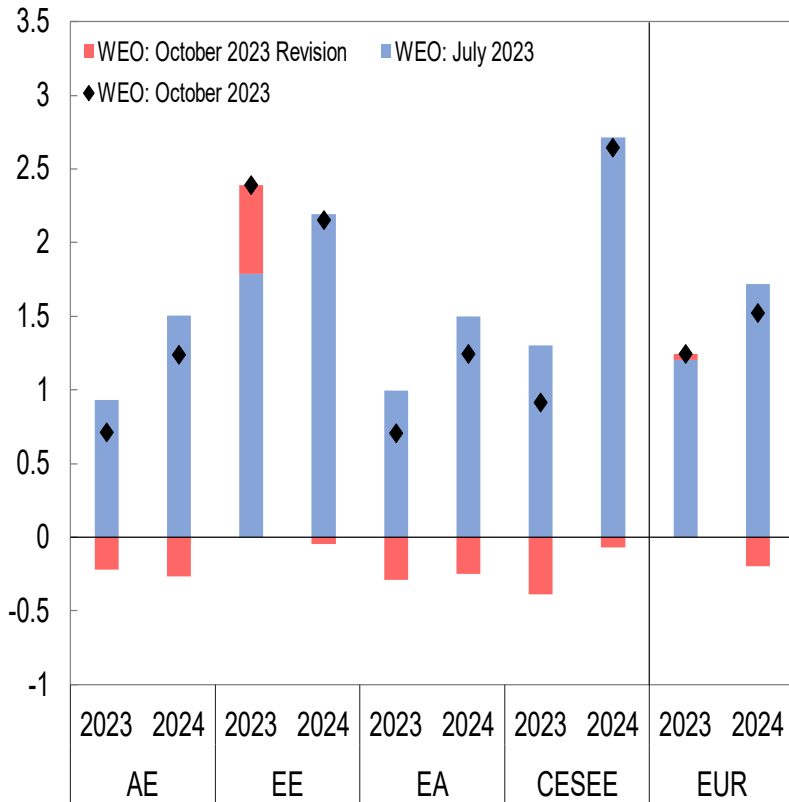
Sources: European Commission, Haver Analytics and IMF staff calculations.

Note: Real income and consumption refer to gross adjusted disposable income and final consumption expenditure deflated by consumer price index.

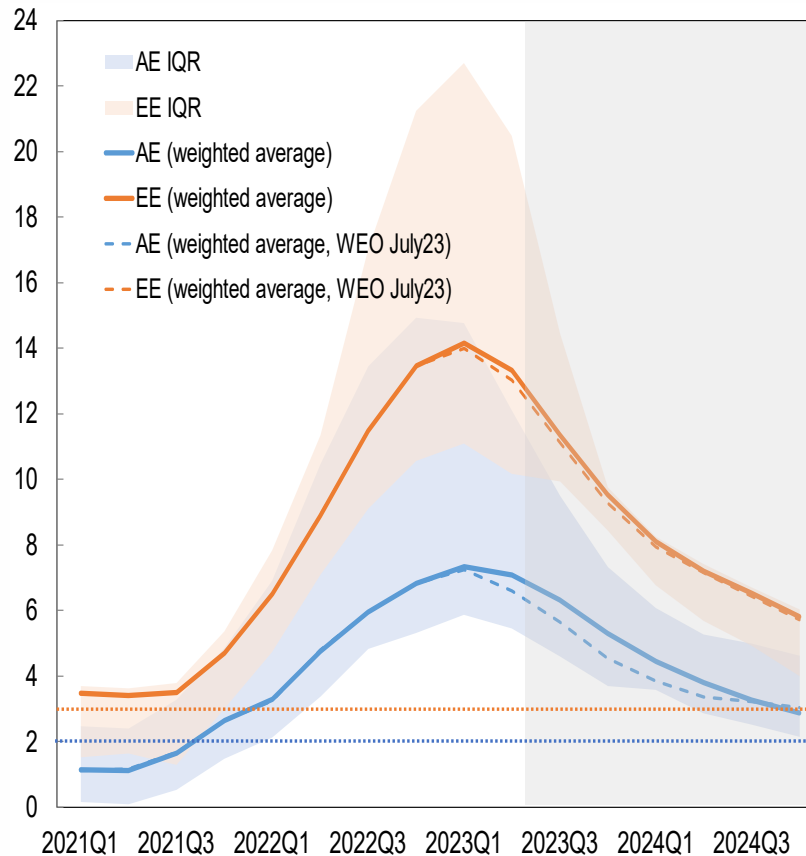
Outlook weak, core inflation up, and headline above target until 2025

Near-term Outlook

GDP Growth (percent)

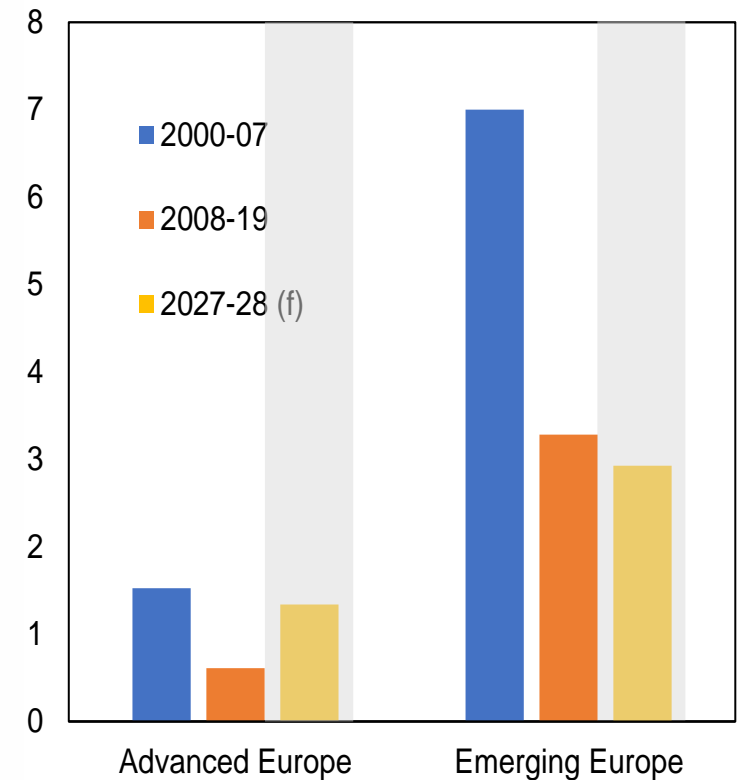


Core Inflation (percent, y/y)



Medium-term Outlook

GDP per-capita Growth (percent)



Sources: World Economic Outlook, and IMF staff calculations.

Note: AE = Advanced Europe; EE = Emerging Europe. EE sample excludes BLR, RUS, TUR, and UKR. Dotted orange and blue line in inflation panel indicates the median central bank target for EE and AE respectively. IQR is interquartile range.

Sources: Eurostat, World Economic Outlook, and IMF staff calculations.

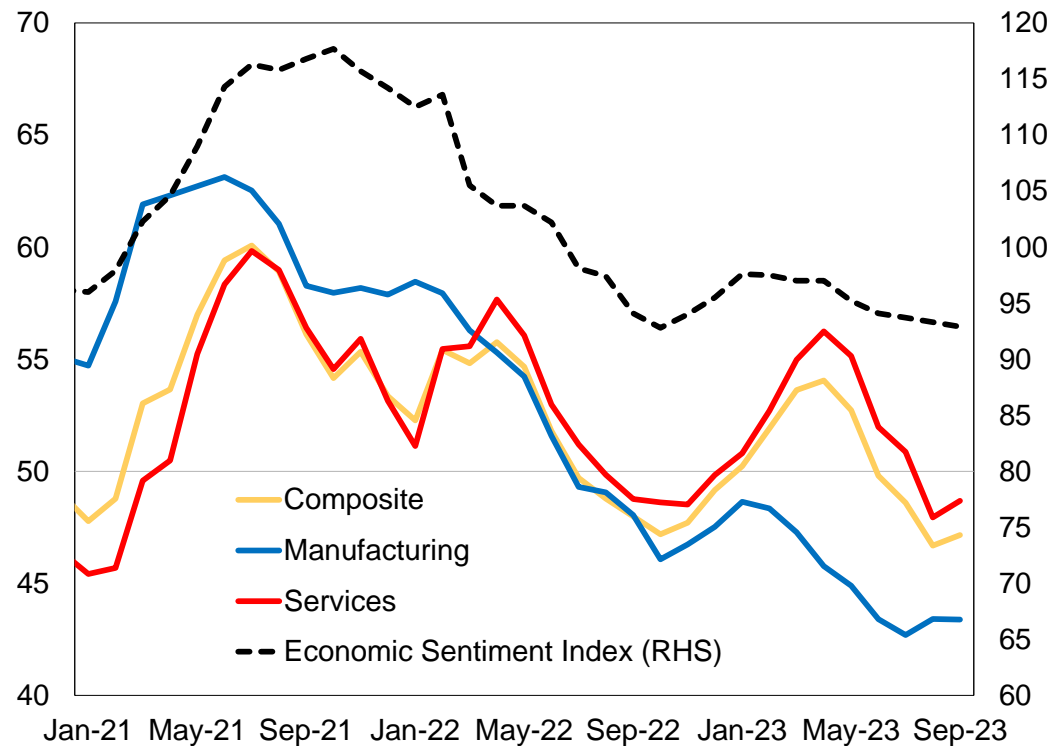
Note: GDP PPP weighted average for advanced Europe and Emerging Europe (EE). EE sample excludes BLR, BIH, UVK, MDA, RUS, TUR, UKR.

II. Broadening risks

Growth could be slower than expected but energy prices higher

EU27: PMI Indices and Economic Sentiment

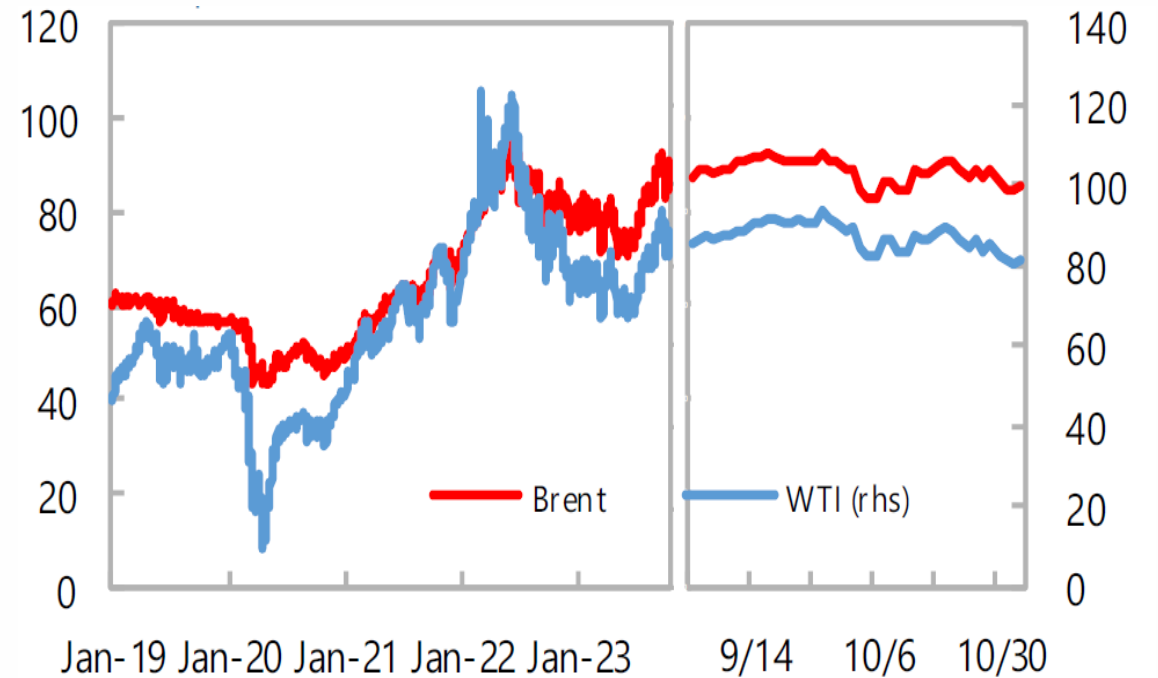
(diffusion index, seasonally adjusted)



Sources: Eurostat; Haver Analytics; World Economic Outlook, Consensus Economics, and IMF staff calculations.

Crude Oil Prices

(US\$ per barrel)

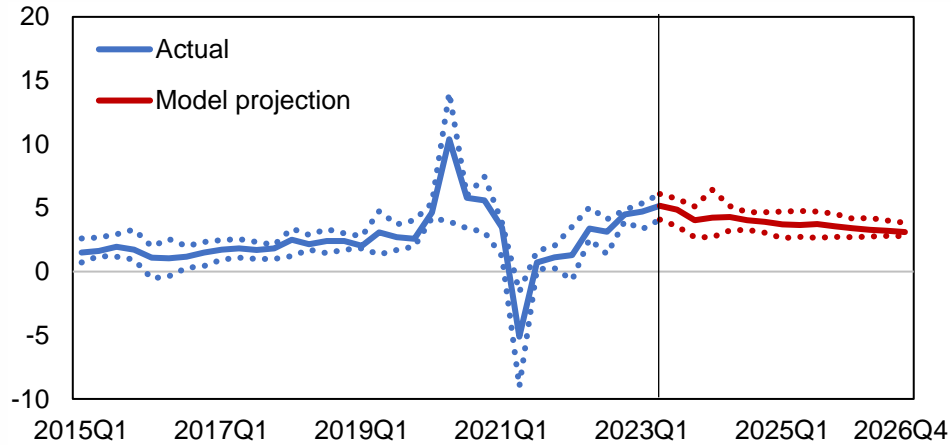


Sources: European Commission, Haver Analytics, and IMF staff calculations.

Upside surprise in wage growth could be costly

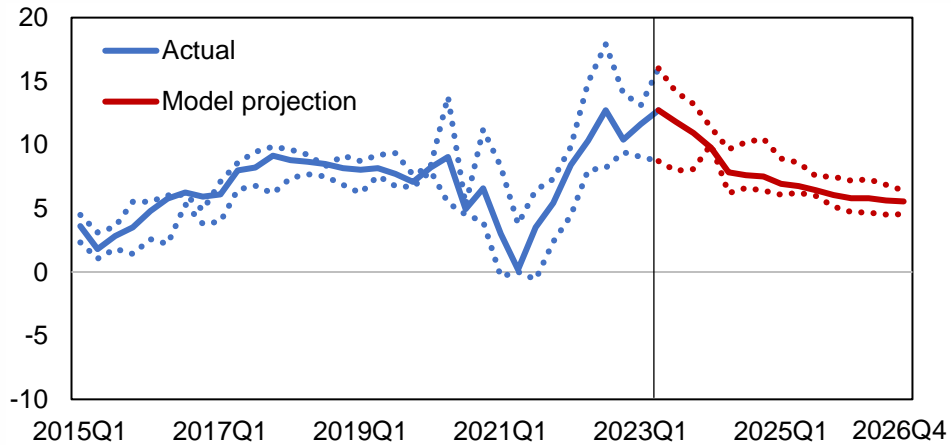
Wage Growth in AE in Baseline

(Percentage points, 4 quarter MA of qoq annualized growth)



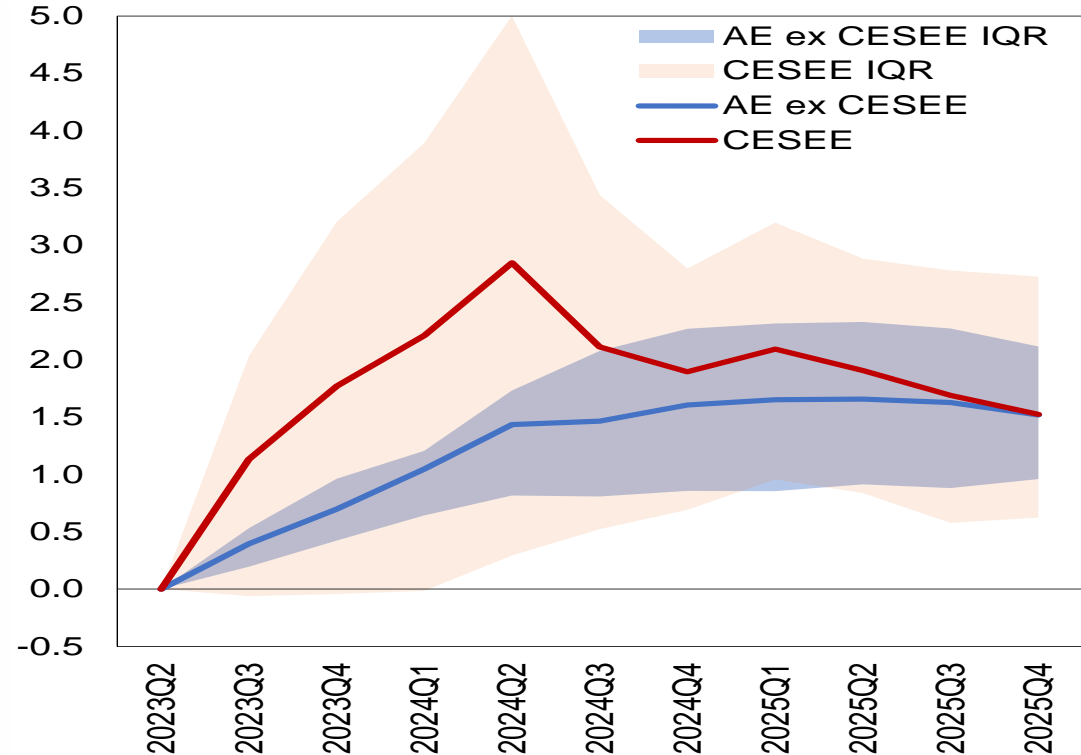
Wage Growth in CESEE in Baseline

(Percentage points, 4 quarter MA of qoq annualized growth)



Wage Growth in Adverse Scenario

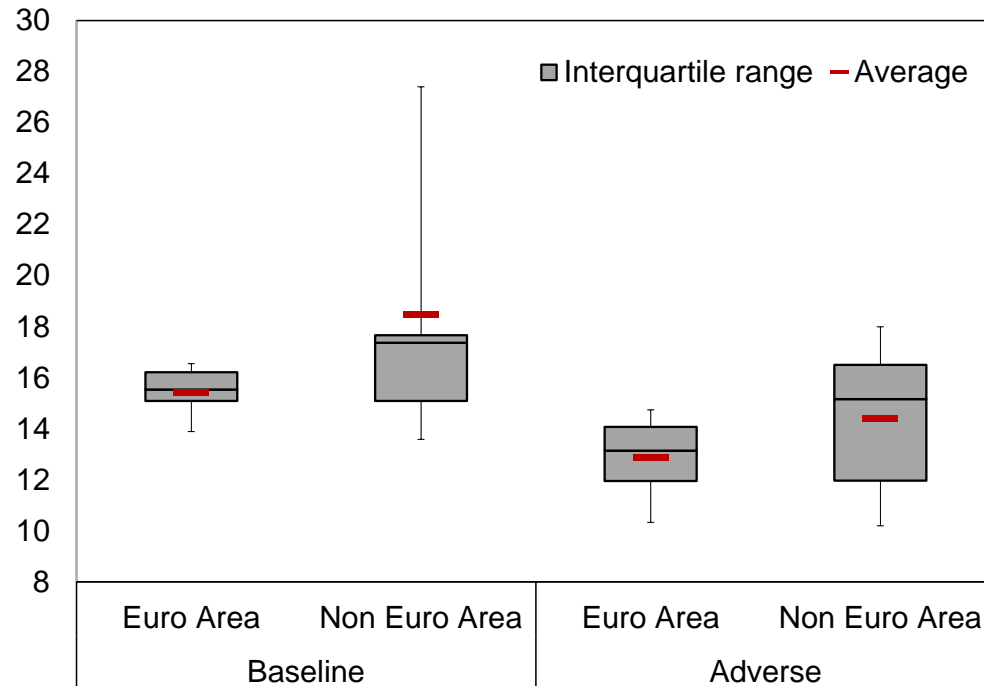
(q/q annualized, percent deviation from baseline; 4Q moving average)



Sources: World Economic Outlook, Consensus Economics, Haver Analytics and IMF staff calculations.
 Note: Advanced Europe includes AUT, BEL, DEU, DNK, ESP, FIN, FRA, GBR, GRC, IRL, ITA, NLD, NOR, PRT, SWE and CESEE includes BGR, CZE, EST, HRV, HUN, LTU, LVA, POL, ROU, SVK, SVN. Notes: Estimated from a cointegrating relationship between nominal wages, prices, and labor productivity for each country, using available data from 1990q1-2023q2. The adverse scenario assumes lower slack in the labor market and higher backward-lookingness in the wage formation.

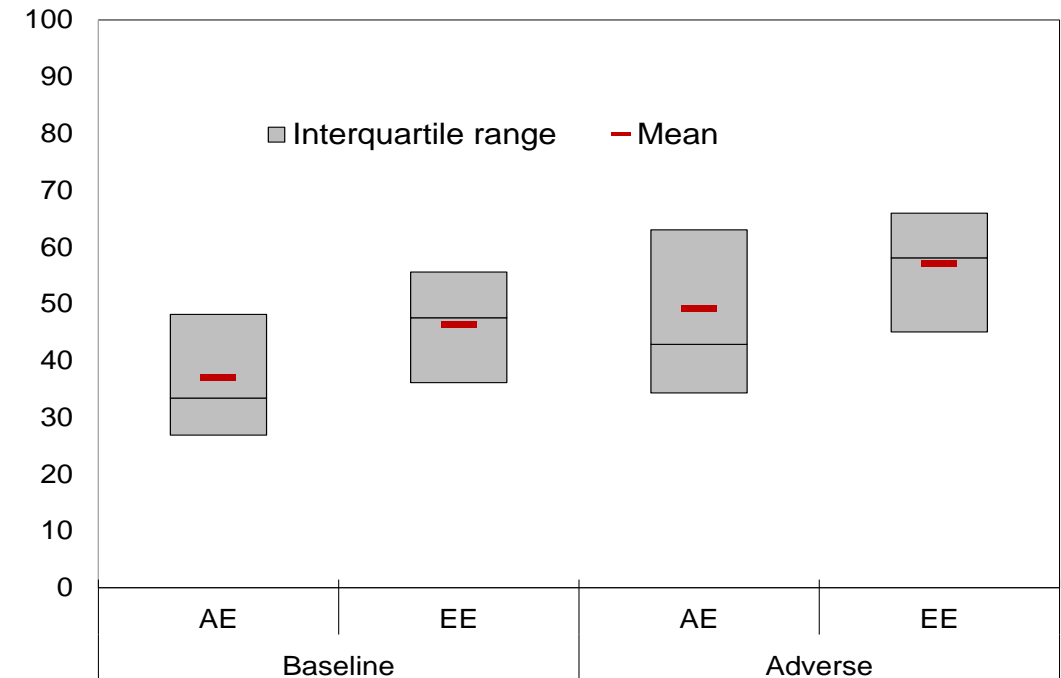
High inflation and lower growth would raise financial and debt risks

**European Bank Common Equity Tier 1
(percent)**



Sources: FitchConnect, World Economic Outlook, IMF staff calculations.
 Note: The adverse scenario assumes more persistent inflation and a global economy contraction of about 2 percent in 2023, leading to recessions across regions, including in China. The peak global policy rate shock, over the baseline, is about 170 basis points. In the figure capital ratios are reported for the year 2023. See GFSR Ch. 2 (Oct 2023) for further details.

**Probability of Non-stabilizing Public Debt in the Medium-term
(percent)**



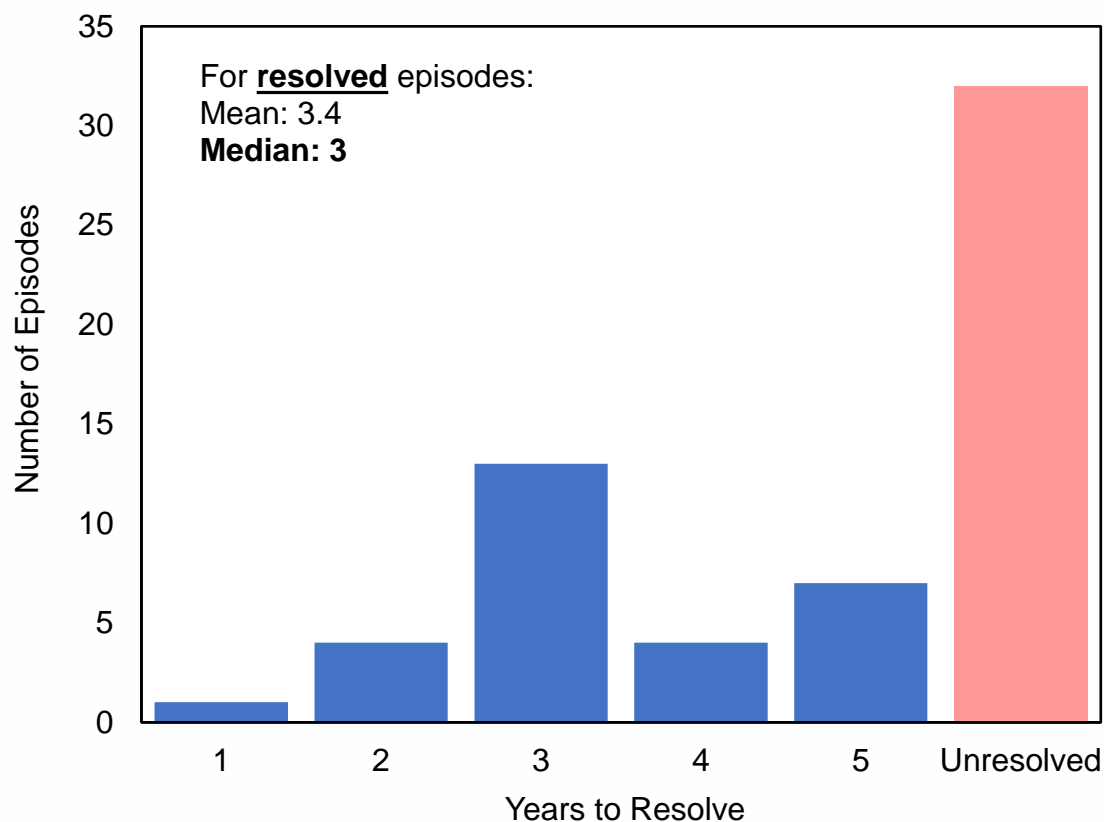
Sources: World Economic Outlook, IMF staff calculations.
 Note: AE= Advanced Europe, EE= Emerging Market Europe. Adverse scenario similar to that in the left panel but in addition assumes that compared to the baseline, the negative growth shock (i) reduces output by 1 percentage point of GDP per year in 2024 and 2025, (ii) leads to a lower primary balance by 1 percentage point of GDP and higher real effective interest rate by 50 basis points for AE, and 100 basis points for EE in 2024-2028.

III. Policies

Prolonged restrictive stance needed to restore price stability

Historical Inflation Persistence

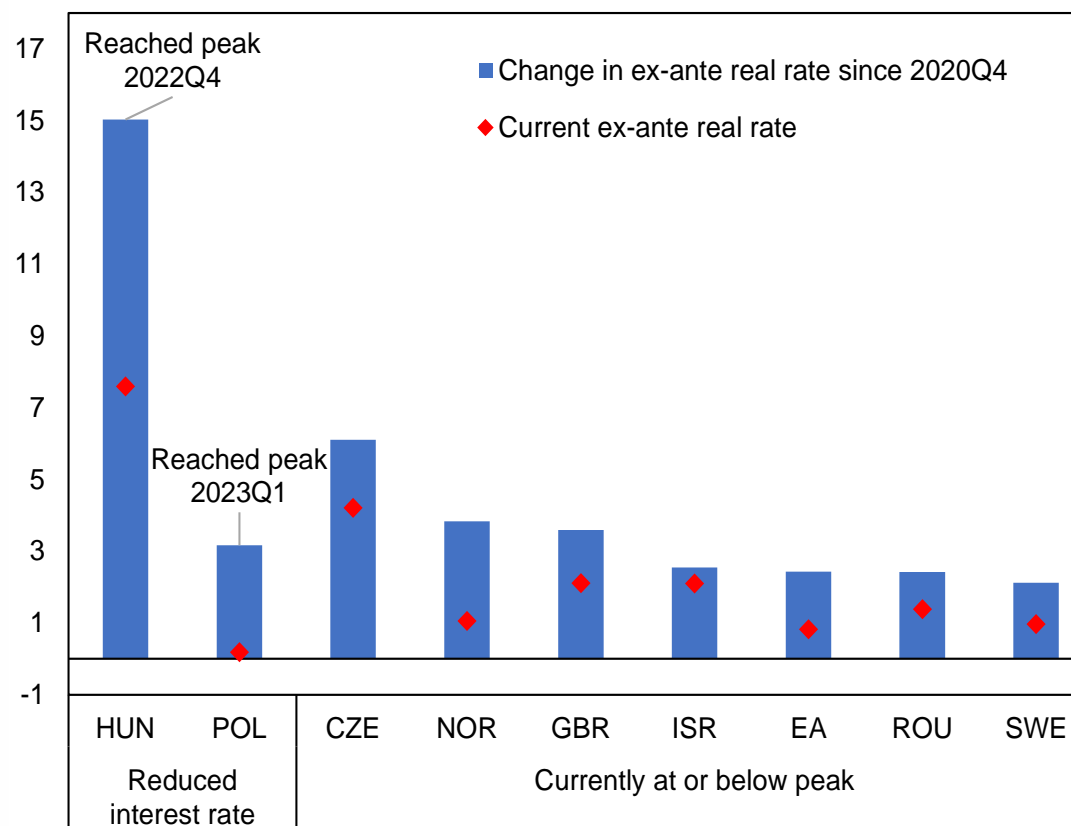
(Years until inflation falls to within 1 pp of its pre-shock rate)



Sources: Ari, A., Mulas-Granados, C., Mylonas, V., Ratnovski, L., and Zhao, W. (2023). *One Hundred Inflation Shocks: Seven Stylized Facts*. IMF Working Paper, WP/23/190;
Note: Episodes associated with the 1973-79 oil crises. Unresolved episodes are those where inflation remains at least 1 percent above the pre-shock rate after 5 years.

Real Rate Change and Monetary Stance in Select Countries

(Percent)

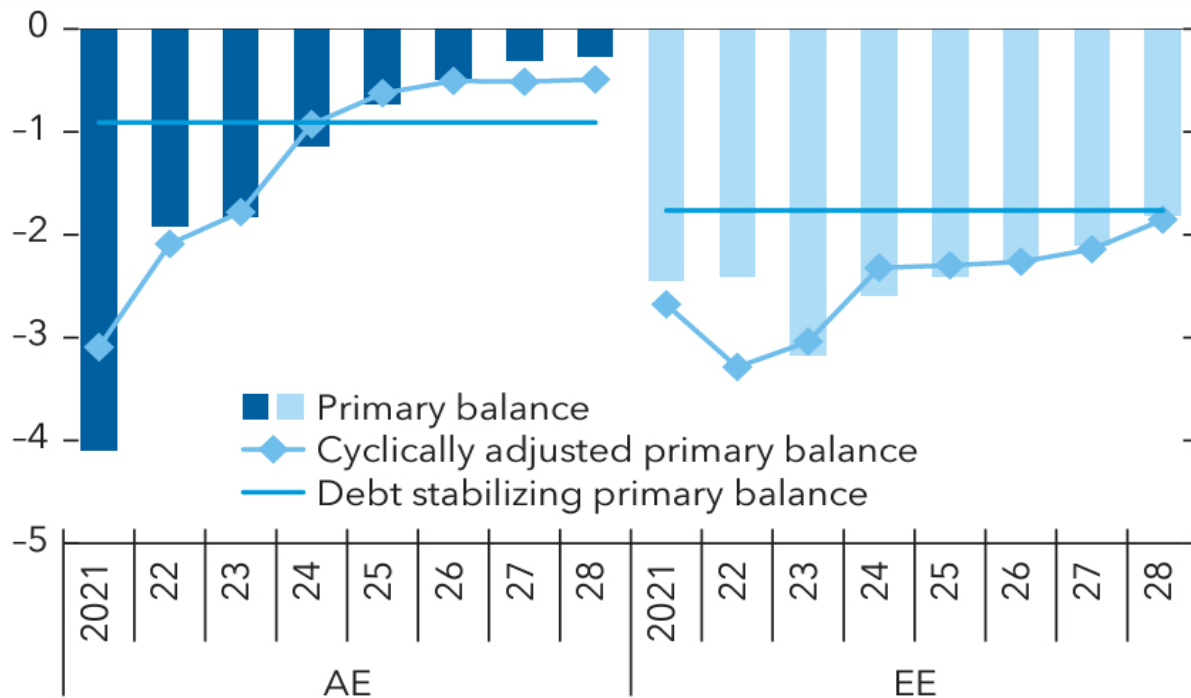


Sources: Haver Analytics and IMF staff calculations.
Note: Data as of end-September, 2023. For countries which have eased, the blue bars represent the real rate change between the month before nominal rate easing and 2020Q4. Ex-ante real rates are calculated using consensus one-year ahead inflation expectations or desk projections. For Hungary, the one-day deposit tender is used as the de facto policy rate between October 2022-September 2023.

More consolidation needed and revenue mobilization can help

Fiscal Balances

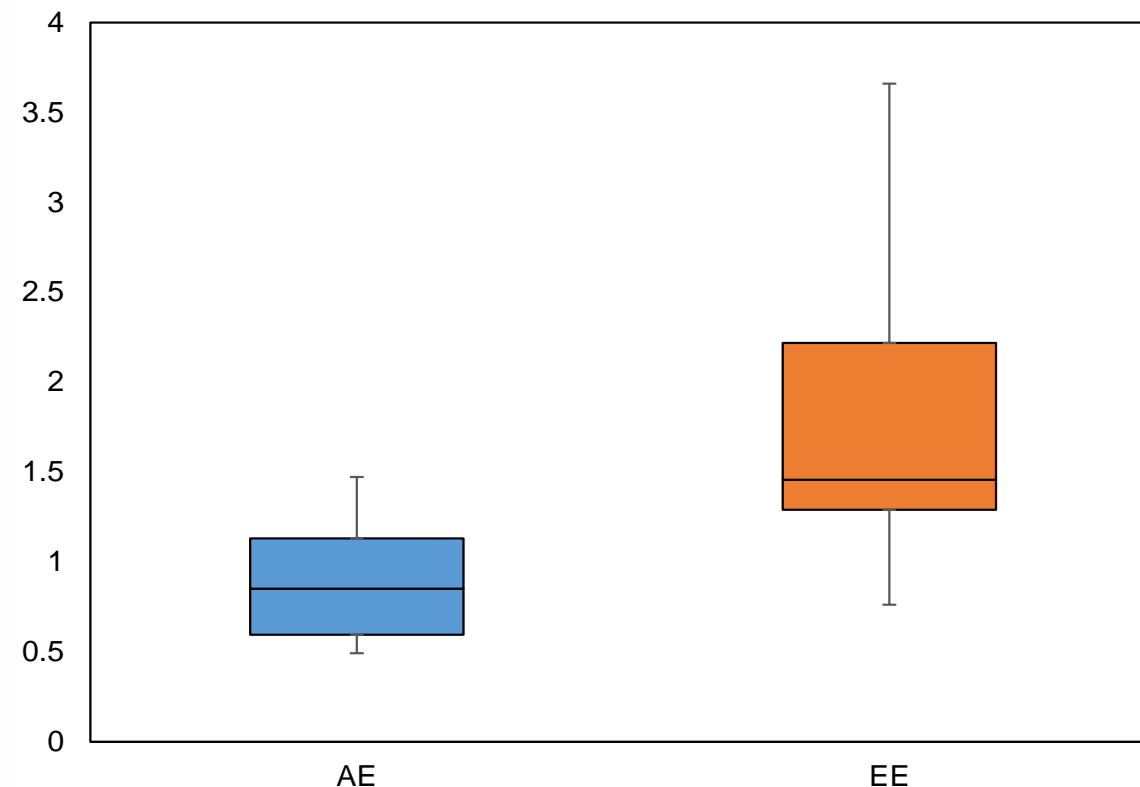
(In percent, 2023-28)



Sources: IMF WEO ; GDP purchasing power parity-weighted average for AE and EE. European emerging market economies excludes Belarus, Russia, Türkiye, and Ukraine

Revenue Mobilization Potential in Europe: Gains from Tax System Reform and Institutional Capacity Building

(Revenue gains as percent of GDP)



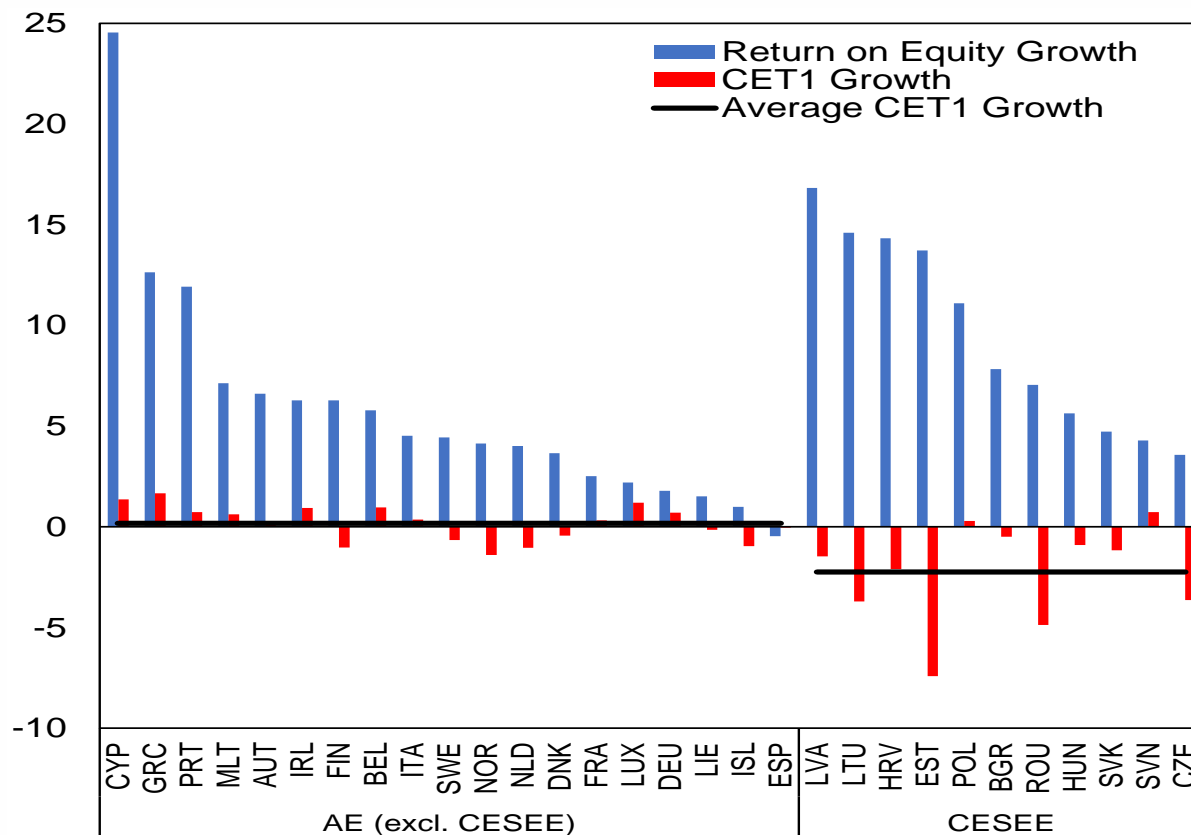
Sources: Benitez et. al. (2023)

Note: AE= Advanced Europe, EE= Emerging Market Europe The figures report the distribution of tax gains (in percent of GDP) across Advanced and Emerging Market European countries. Tax gains are estimated by closing the gap between the country's observed level of tax collection and its tax potential which is the highest observed level controlling for country characteristics. EE excludes BLR, UKR, and RUS.

Build bank buffers and ditch distortionary policies

Bank Profits and Capital Buffer

(growth rate between 2021Q1 and 2023Q1 in percent point)

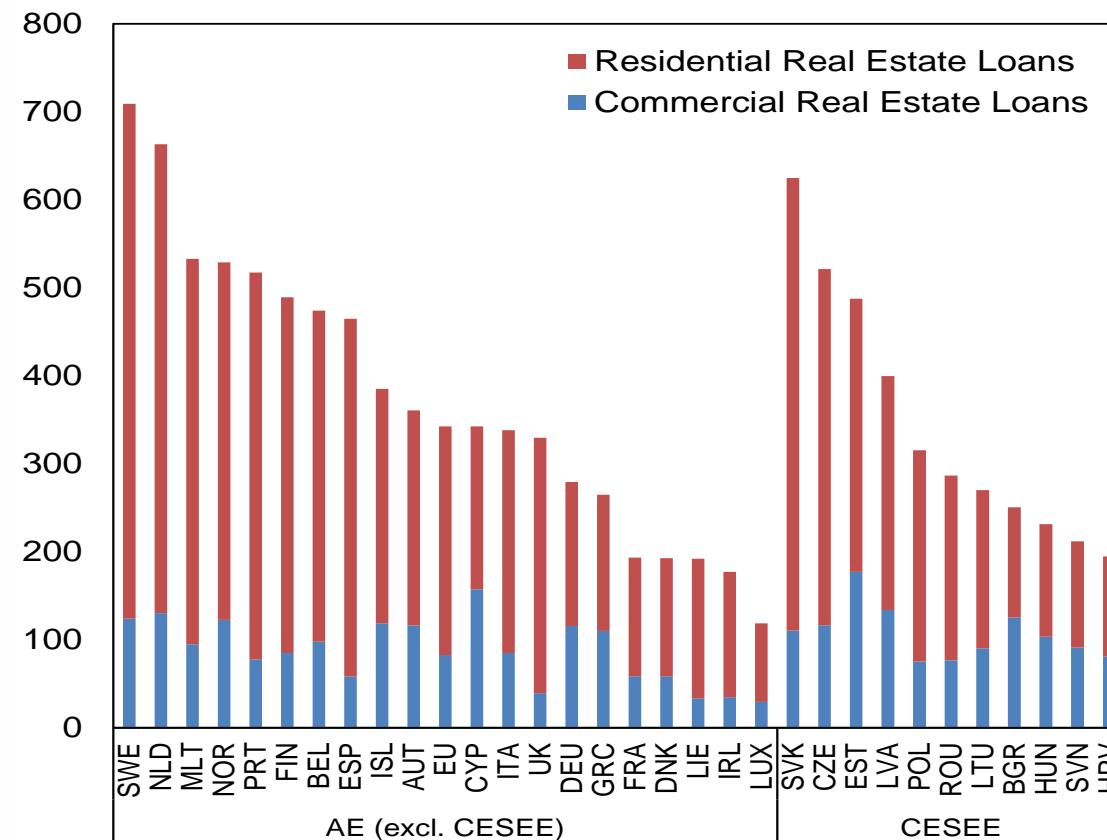


Sources: European Banking Authorities(EBA) and IMF staff calculations.

Note: For Spain, growth rates are between second quarter 2021 and first quarter 2023 as the first quarter of 2021 saw a sharp increase in return on equity from the realization of extraordinary gains due to the merger of two banks, among other things.

Bank Credit Exposure to Domestic and Foreign Real Estate

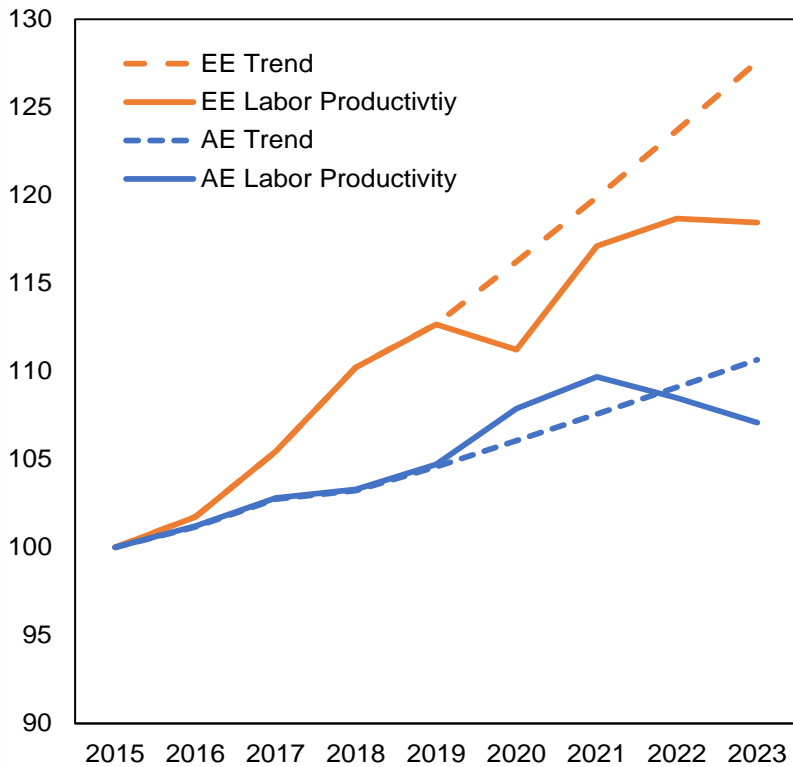
(percent of Tier 1 Capital in 2023Q1)



Sources: European Banking Authorities(EBA) and IMF staff calculations.

Boost output by supply-enhancing reforms and raising capital stock

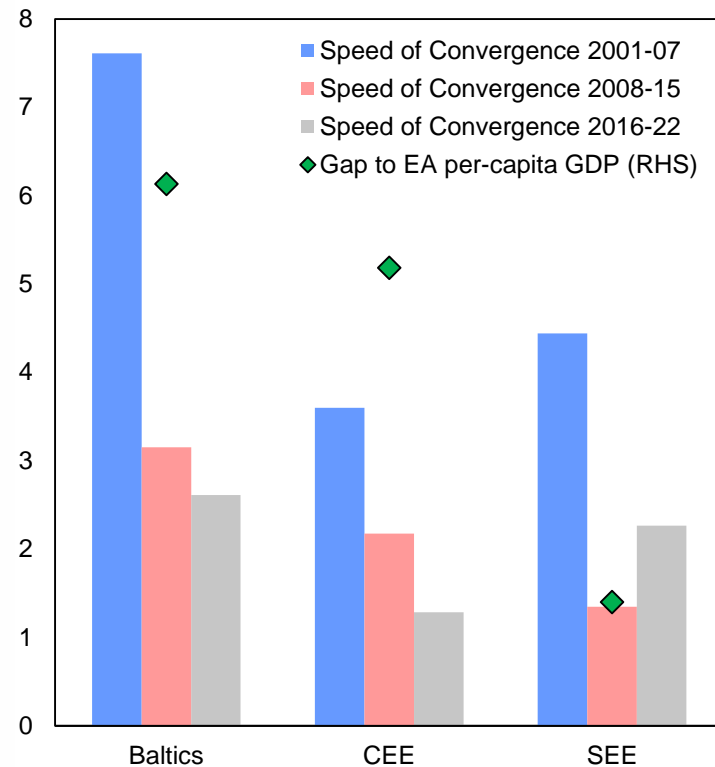
Labor productivity Trend
(Index, 2015=100)



Sources: World Economic Outlook, Haver Analytics and IMF staff calculations.

Note: Labor productivity is measured by output per hours worked. Trend productivity is calculated based on the productivity growth average between 2015-2019. AE= Advanced Europe, EE= Emerging Market Europe. Simple average for AE and EE. EE sample includes BGR, HRV, HUN, POL, ROU.

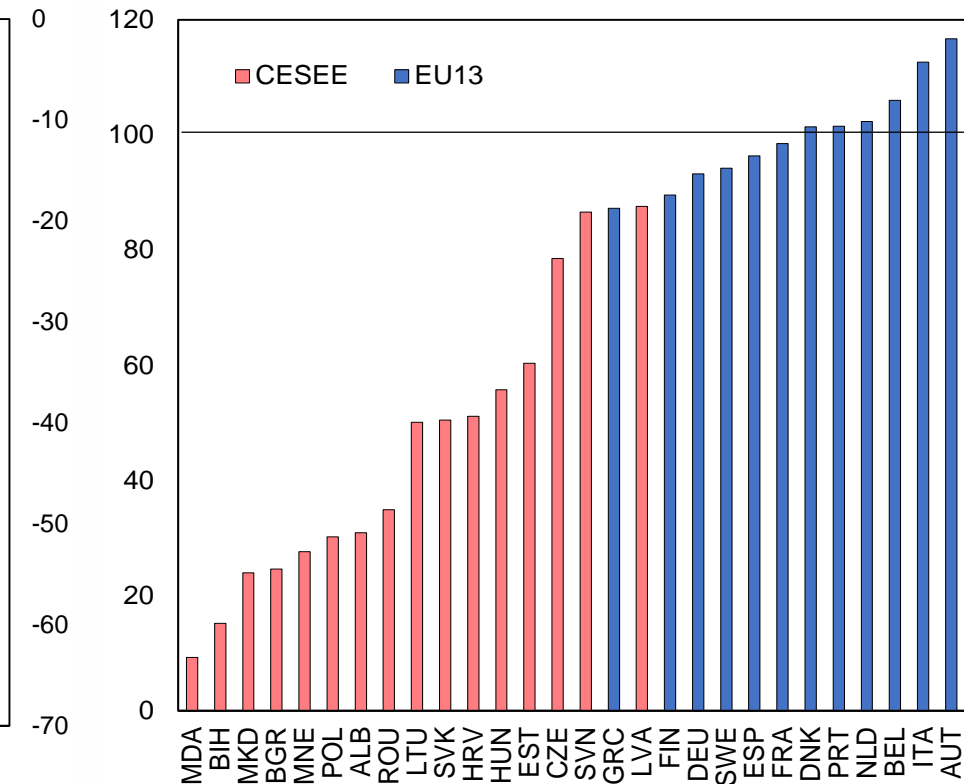
CESEE GDP per-capita: Speed and level of convergence to EA
(Average growth and difference in RHS)



Sources: Eurostat and IMF staff calculations.

Note: "Speed of convergence", defined as the growth rate of per capita GDP at PPP relative to the euro area economy (EA19 definition). In each group, the median per capita GDP is considered. CEE= Central European Economies, SEE= Southeastern European Economies

Per-Capita Capital Stock in 2022
(In percent of EU13 average)



Sources: Eurostat and IMF staff calculations.

Note: EU13 is former EU15 less GBR, IRL

Key messages

Conjuncture

Shaped by opposing forces.

Outlook

Soft landing. Inflation to remain above target until 2025 for most countries.

Risks

Lower growth, higher inflation, excess wages.

Policies

- Monetary policy.** Appropriately tight. Maintain restrictive stance.
- Fiscal policy.** Build buffers through more consolidation and aid disinflation.
- Financial policy.** Preemptively address pockets of strain. Increase capital buffers
- Structural Policies.** Tackle barriers to productivity growth. Protect *Single Market*.

Thank you.

Baseline forecast

Year	Real GDP Growth						CPI Inflation (average of the year)					
	2023		2024		2025		2023		2024		2025	
WEO vintages	WEO Oct	Diff. since Jul. 2023	WEO Oct	Diff. since Jul. 2023	WEO Oct	Diff. since Jul. 2023	WEO Oct	Diff. since Jul. 2023	WEO Oct	Diff. since Jul. 2023	WEO Oct	Diff. since Jul. 2023
Europe	1.3	0.1	1.5	-0.2	2.1	0.0	10.4	0.7	9.3	2.8	7.2	2.1
Advanced Europe	0.7	-0.2	1.2	-0.3	1.9	0.0	5.8	0.2	3.3	0.3	2.2	0.1
Euro area	0.7	-0.2	1.2	-0.3	1.8	0.0	5.6	0.4	3.3	0.5	2.2	0.1
Emerging Europe	2.4	0.6	2.2	0.0	2.5	0.2	20.4	1.6	22.3	7.9	17.9	6.3
Emerging Europe excl. Belarus, Russia, Turkey, and Ukraine	1.1	-0.4	2.9	0.0	3.5	0.0	11.9	0.0	5.8	0.3	4.0	0.1

Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

Notes: Projections are updated as of November 2, 2023.