ECONOMIC RESEARCH | 14th of October 2022

WEEKLY ANALYSIS

M. Alain Freymond—Partner & CIO

45% RISK PREMIUM FOR EUROPEAN EQUITIES

Europe still avoids recession. Confidence at its lowest. Inflation reaches +10%. The ECB follows a more moderate strategy. Yield curves still positive. Excessive fall in European real estate. Equity risk premium of 45%.

Key points

- Can Europe repeat its relative performance in Q3 and avoid a decline in GDP?
- Still uncertain outlook for Q4
- Leading indicators still very hesitant
- Household confidence at historic low
- No sustainable respite for inflation yet
- Decline in household and business confidence
- More flexible and progressive ECB policy
- Yield curves still positive
- Securitised real estate is in turmoil
- Risk premium still high for European equities

Can Europe repeat its relative performance in Q3 and avoid a sharp decline in GDP?

The positive economic growth of the 2nd quarter (+0.8%) had largely surprised economists by significantly exceeding their more moderate growth estimates (+0.2%). This was already the case in the first quarter, which was surprisingly resilient, particularly in view of the already negative trend in US GDP. The European economy ended the first quarter with growth of 0.5%, significantly higher than expected, even though the geopolitical crisis was already having its first clear inflationary effects. European GDP was then growing almost as much as we expected before the invasion of Ukraine (+0.6%).

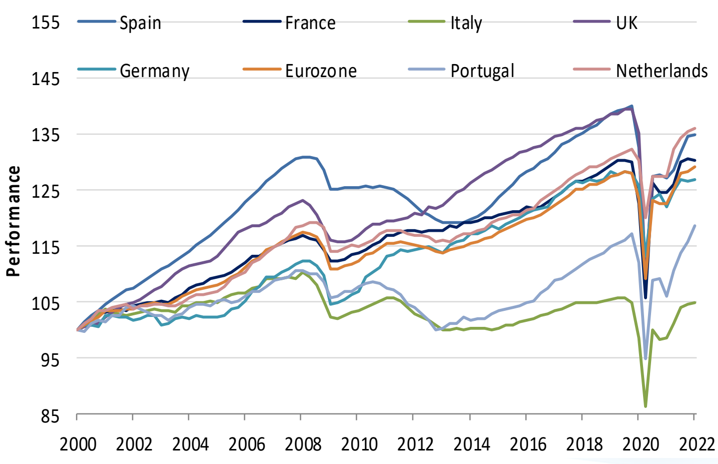
Without any real reduction in uncertainty and in a particularly tense context in terms of oil and gas supply and its effects on inflation, the European economy had once again outperformed the US economy in the 2nd quarter. While the US saw its GDP fall for the second consecutive quarter by -0.9%, the European economy grew by 0.7% at the end of June. The European economy is surprisingly resilient in the first half of the year, even though it is facing stronger domestic and international headwinds. Domestic demand is affected by the decline in household and business confidence, while external demand is weakening with the US recession and anaemic growth in China.

The European economic slowdown remains, however, widely perceived as inevitable in the second half of the year. Germany, already in overdrive at the end of June with a GDP of +0.1%, could succumb in the 3rd quarter to the various tensions and the weakening of numerous economic indicators, such as retail sales (-1.3%), factory orders (-2.4%) industrial production (-0.8%) and a fall in consumer confidence (-42.5). The French GDP, up by +0.5% at the end of June, could however resist a little better to the pressures observed during the summer. The declines in household consumption in July (-0.8%) and industrial production (-1.6%) were partly followed in August by better statistics.

Overall, however, GDP in the euro zone could still surprise by its resilience and even grow quite significantly by around +1.5%, if the growth forecasts for France (+1%), Germany (+0.7%) and Spain (+3.9%) become reality.

European GDP should therefore still avoid a decline in the third quarter despite the difficulties encountered by the German economy.

Quarterly GDP growth-Europe



Sources: Bloomberg, BBGI Group SA