



PIIE PETERSON INSTITUTE FOR
INTERNATIONAL ECONOMICS

The Surprisingly Shock Resilient European Economy

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PIIE Global Economic Prospects March 28th 2023

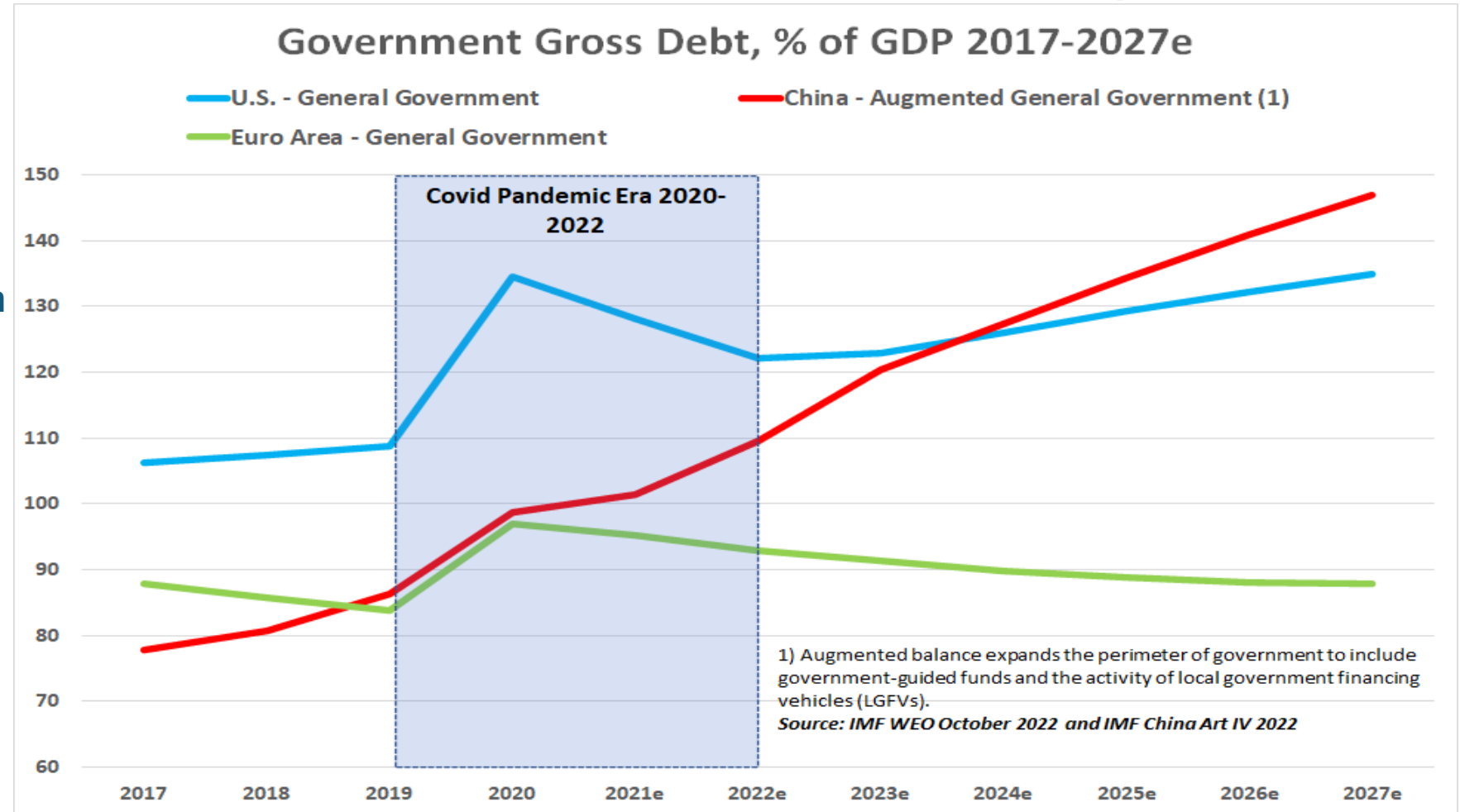
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Key Points:

- **EU27 exited Covid-19 pandemic in a strong position**
- **EU27 labor markets remain historically strong and will provide support for households and consumption going forward**
- **European corporate profit rates remain, despite energy price shock, at historical trend, supporting labor market resilience (and core inflation)**
- **EU27 natural gas prices back not far above historical levels, while CO2 prices – a policy choice – are €80-100 (and rising)**
- **ECB monetary policy tightening will likely end in Q2 2023 (not because of financial stability concerns), while EU fiscal impulse will be mildly negative in 2023-24, despite rising defense expenditure**

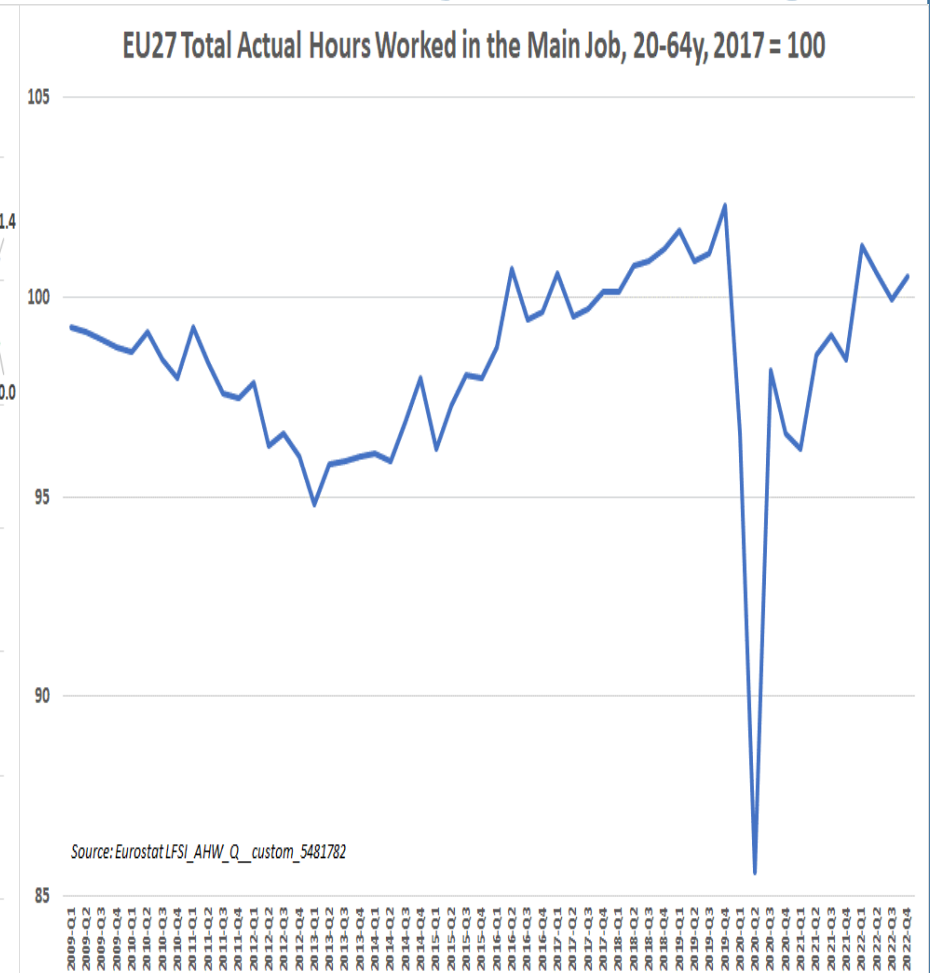
EU Had a Good Post-Pandemic Starting Point

- The EU27 came through the Covid-19 pandemic as arguably "best in class"
- "Wage subsidization model" proved superior in facilitating immaculate reopening
- No lasting "long-Covid labor market effects"
- Fiscal outlays were in hindsight of an appropriate scale



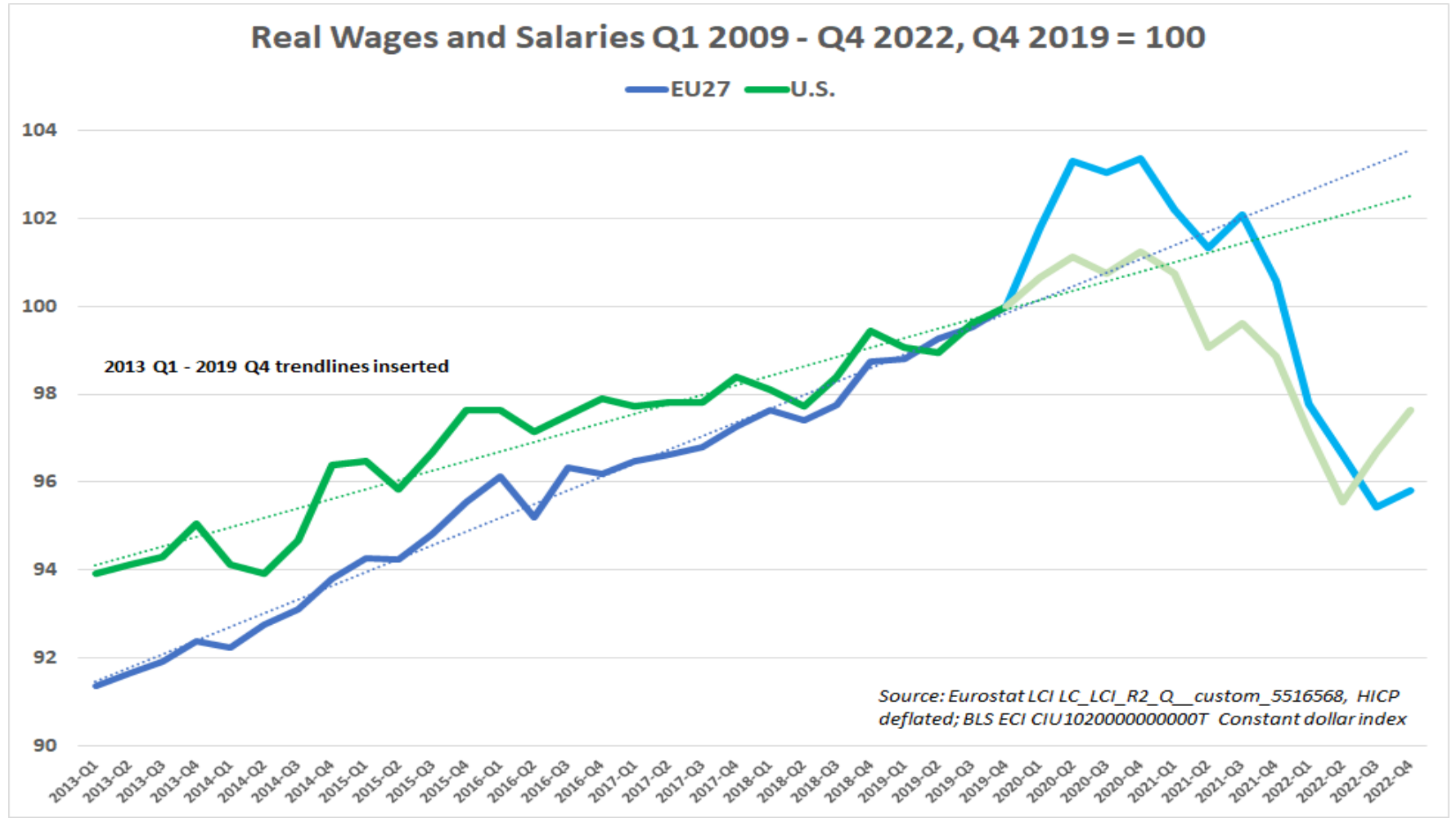
European Labor Markets Are Historically Strong

- European unemployment rates are at historic lows (EU27 at 6.1%)
- Employment rate well above pre-pandemic highs at 70%
- Overall the pandemic era use of "short-term work" no longer reduces aggregate total hours worked
- Increased remunerated labor input is a positive fiscal surprise, too



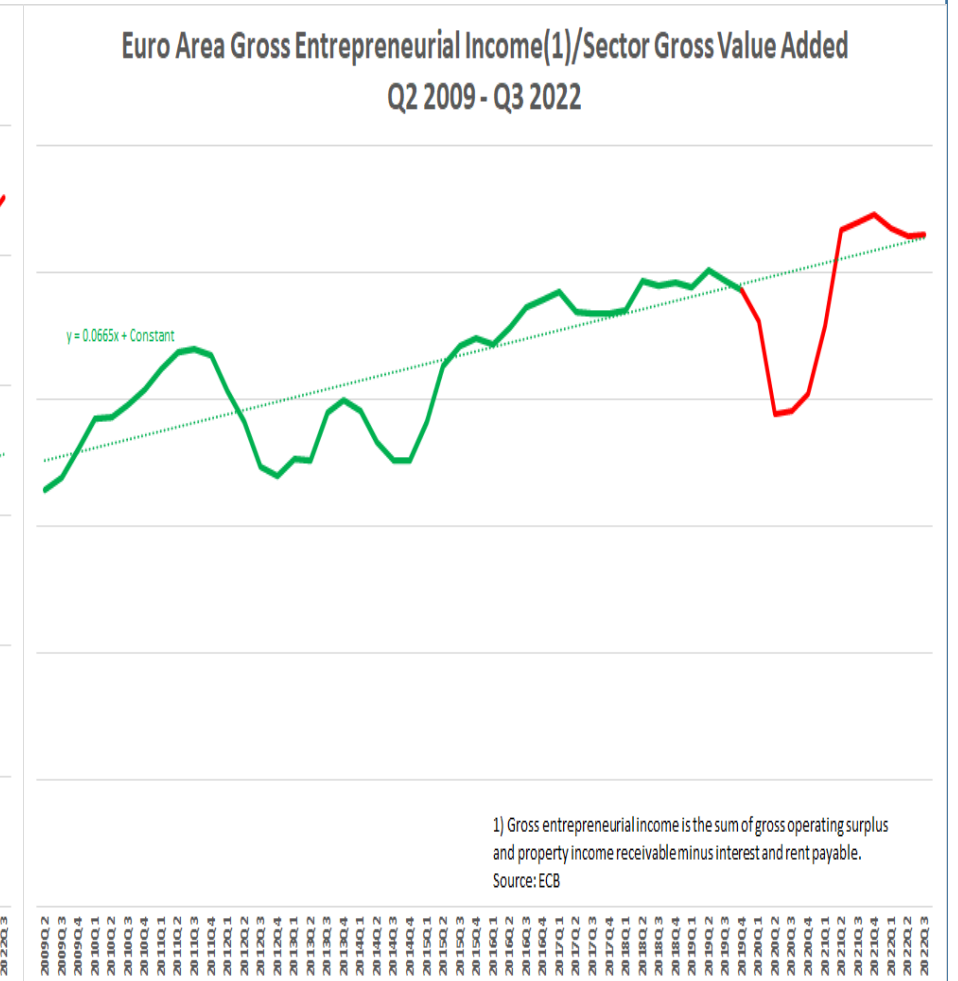
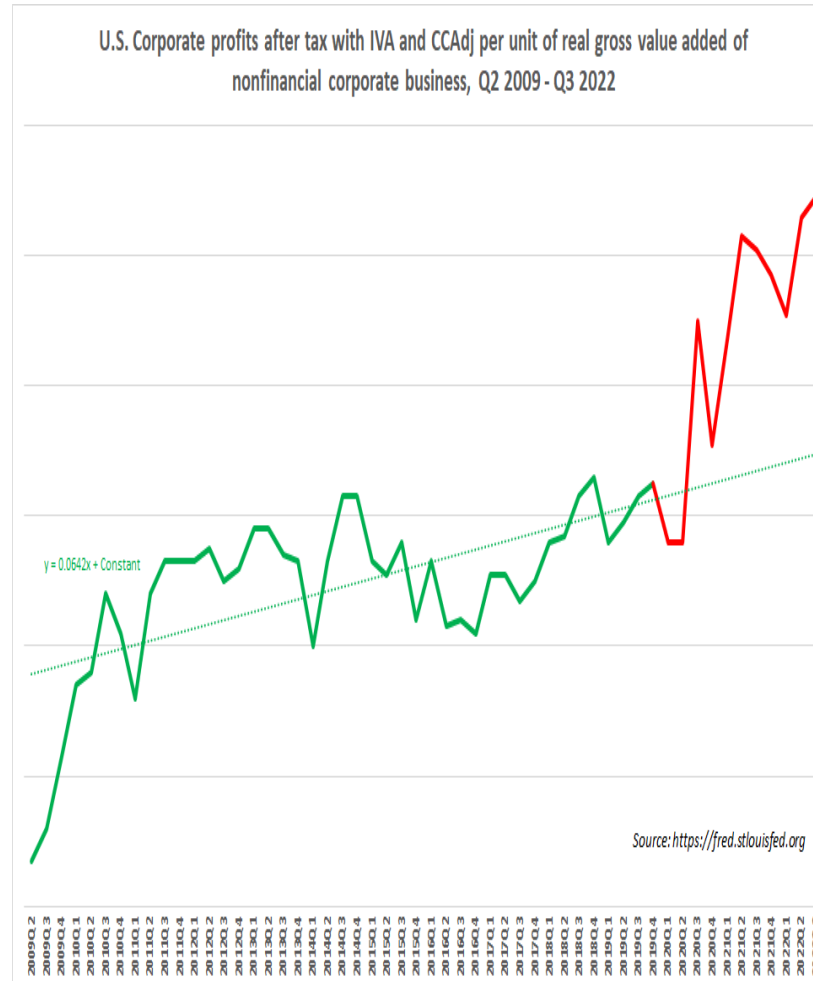
EU27 Real Wages Remain “Very Prudent”

- Dramatic EU27 real wage decline after energy prices started to rise in mid-2021
- ECB forward-looking wage tracker ~5% nominal wage growth in 2023 and ECB macro-forecast shows ~3% HICP end-2023 = implied 2% real wage increase
- Real wage drop clawed back in ~3y only ≠ price-wage spiral!!!



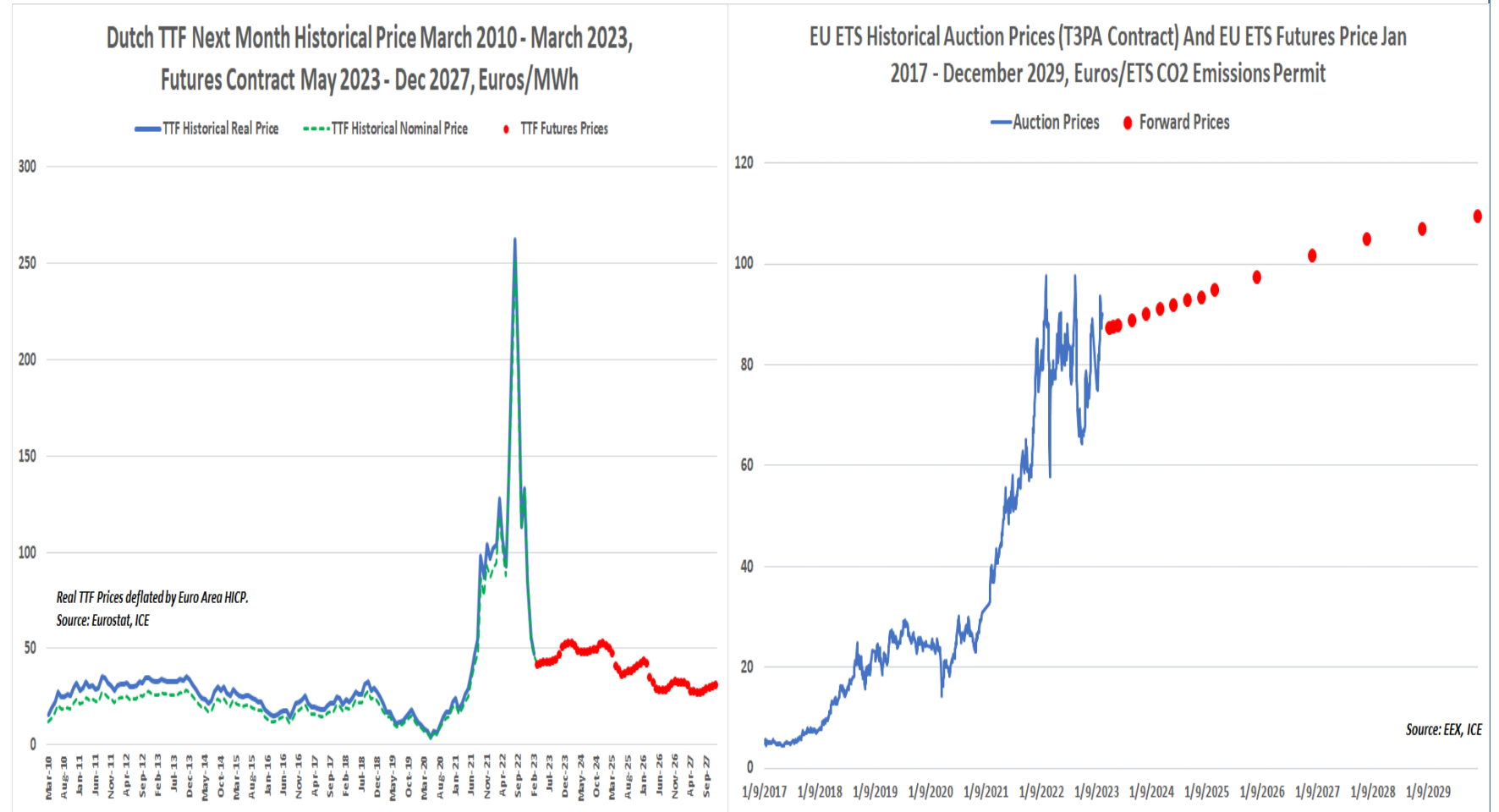
European Corporate Profit Rates Remain O.K.

- European corporate profit rates are not stratospheric like in the U.S..... But
- European corporate profit rates are back at their long-term trend..... Not too bad after facing an unprecedented energy price shock
- Resilient corporate margins suggest continued resilient hiring intentions



Europe's Energy Shock is Now A Policy Choice

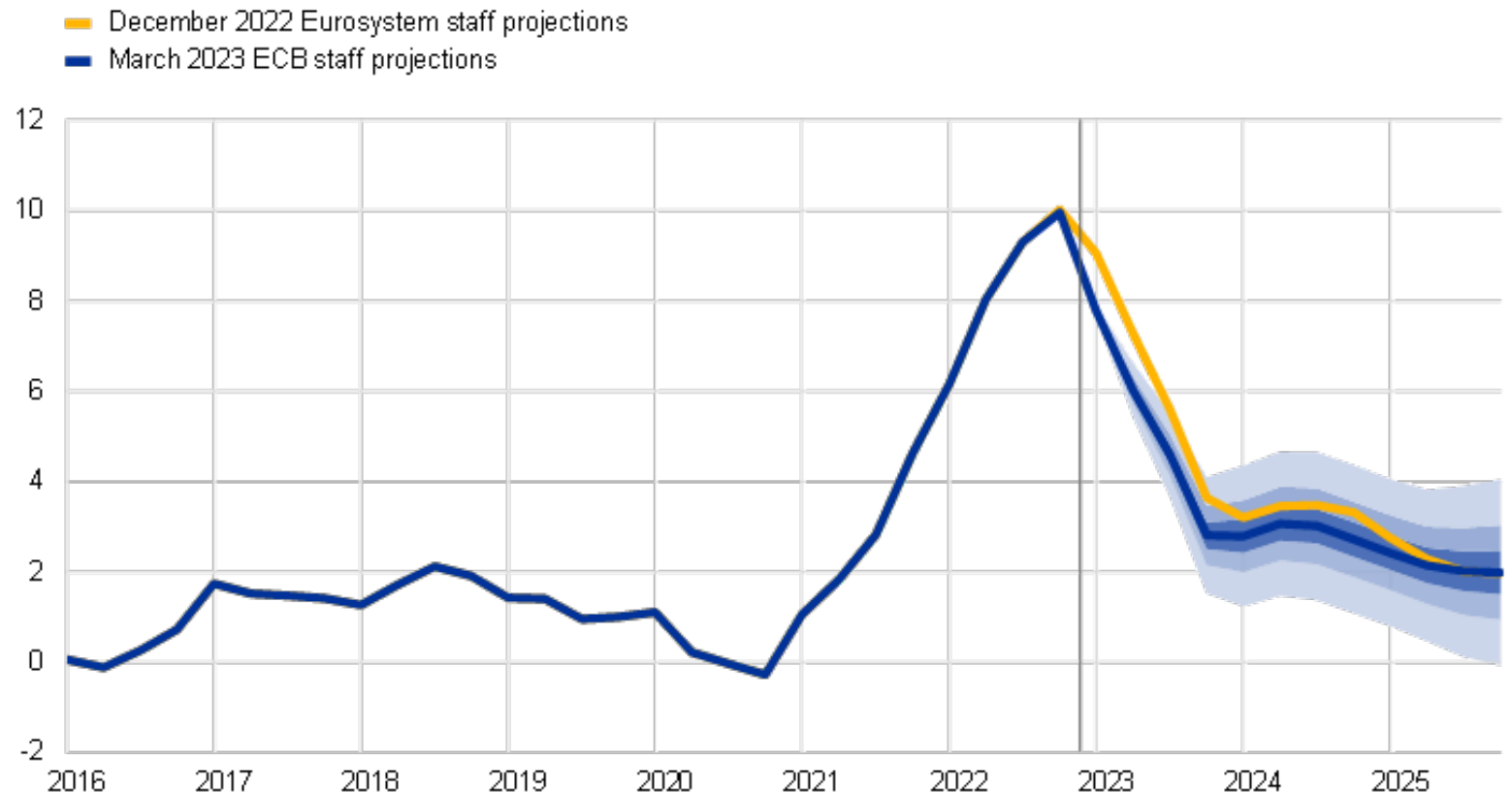
- European natural gas prices have dropped to levels not THAT much higher than historical real prices
- Forward prices indicate ample global LNG supply available for Europe in coming years
- Meanwhile – true permanent energy price shock in Europe is a CO2 price at €80-100 and rising



EA HICP Will Come Down (Even) Faster Than ECB Thought

- ECB march forecast = EA HICP to reach >3% end-23/2.0% in Q3 '25
- BUT forecast cut-off date of Feb 15th = NOT include effects of SVB, CS and EA bank stocks↓↓
- TTF natural gas prices fallen 15-30% (spot/year-end 2023) below ECB '23 assumption of €58/MWh
- Brent oil prices fallen 10-15% (spot/year-end 2023) below ECB 2023 assumption of €83/barrel
- EU wholesale power prices fallen 15-25% (spot/year-end 2023) below ECB 2023 assumption of €158/MWh

ECB Forecast Euro area HICP Inflation



Economic Impact of the War in Ukraine

- **Short-term energy price shock now over (and Putin has lost his blackmail capability)**
- **Boost to EU defence spending will be permanent and at least ~0.5% of GDP/year**
- **Rebuilding Ukraine will be overwhelmingly paid by the EU27 = implications for further EU fiscal integration**
- **A victorious Ukraine is essentially certain to become a member of the EU by early 2030ies, necessitating a comprehensive reform of the EU itself**



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