

# Europe macro tracker

## Inflation and COVID-19 cases rising

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Economics - Europe

- ◆ Eurozone inflation hit a record of 5.9% y-o-y in February, while in the UK it rose to a 30-year high of 6.2%...
- ◆ ... and we see further rises over the coming months, coupled with slower growth
- ◆ But prices aren't the only thing rising as COVID-19 cases are up sharply too, delaying the removal of some restrictions

### Inflation at new highs

Once again, the big news this week is on inflation, with the final eurozone reading in February revised up to 5.9% y-o-y and UK CPI inflation hitting its highest level since March 1992 (Chart 24). The oil price has rebounded (Chart 10) and with inflation broadening out (Chart 11), we have raised our inflation forecasts again. We now see eurozone inflation rising to 7.2% in March and remaining around that level through the summer. In the UK, we now expect CPI inflation to peak at 8.4% in April, and then plateau at around 8% through most of the rest of this year, before ending 2022 at 7.7%.

With higher inflation set to squeeze household incomes more tightly, we have revised our GDP growth forecasts. We now expect eurozone growth of 2.6% this year (though it should be noted that even if there was no growth in any quarter of 2022, annual growth would still be 1.9% thanks to a strong base effect from the 2021 rebound) and 2.1% in 2023. For the UK, upward revisions to our Q1 forecast mean we see 2022 GDP growth of 4.3% (up from 4.0%), but for 2023 we have revised down our forecast from 1.6% to 1.1%.

### Central banks pressing ahead with normalisation

Despite slowing growth, the market seems to expect at least as much policy tightening as before the Russian-Ukraine conflict. The Bank of England raised Bank Rate by 25bps in March and we expect further 25bp hikes in May, June and August. So far, periphery eurozone debt spreads have been relatively stable, despite the ECB announcing the end of net asset purchases in Q3.

### COVID-19 cases rising

But just as Europe's economy faces an intensified supply shock from the Ukraine conflict, rising COVID-19 cases serve as a reminder that it has not fully escaped the previous supply shock. Cases are rising across major economies and are at high levels in Germany and Austria (Chart 2). Indeed, Austria became the first European country to re-introduce restrictions, while others (some German regions and Scotland) have delayed the full relaxation of measures (Table 4). But ICU admissions remain low and public concern about COVID-19 (in the UK at least, Chart 5) has dropped to a new low. So while a return to significant economic restrictions seems unlikely, rising infections – and in particular re-infections (Chart 3) – means Europe has not yet left COVID-19 behind.

*This is a Free to View version of a report by the same title published on 23-Mar-22. Please contact your HSBC representative or email [AskResearch@hsbc.com](mailto:AskResearch@hsbc.com) for more information.*

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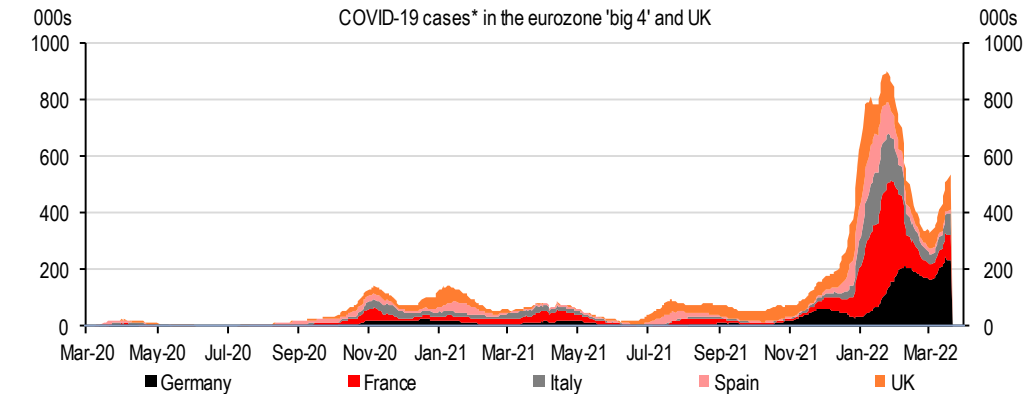
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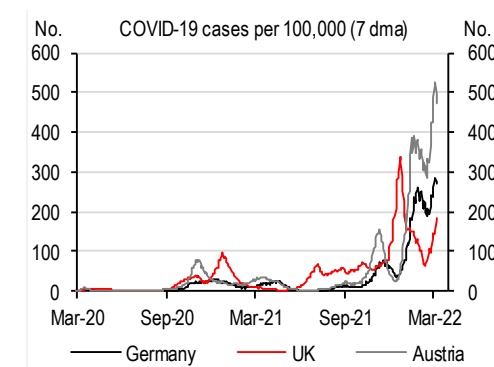
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## COVID-19 in Europe

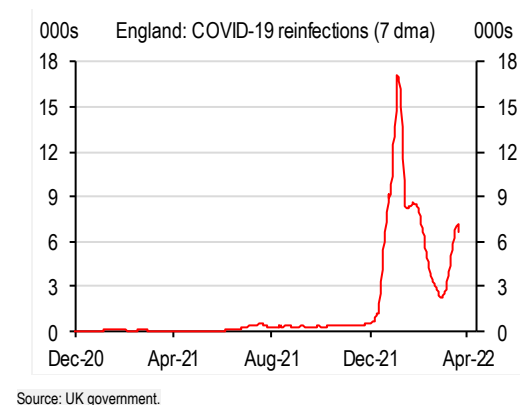
### 1. COVID-19 cases are rising sharply again...



### 2. ...particularly in Germany and Austria



### 3. Reinfections have increased too



### 4. Although the end of some restrictions has been delayed, most have been scrapped

#### COVID-19 restrictions

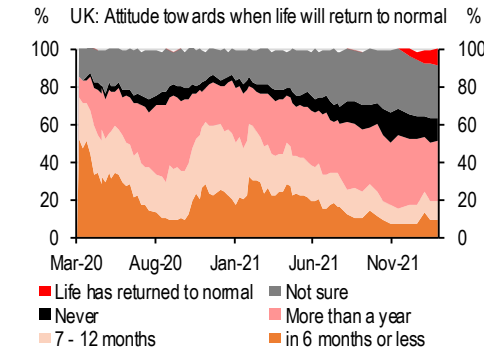
<b>Germany</b>	Since 20 March, most restrictions have been abolished on the national level apart from basic protection measures such as compulsory mask wearing in hospitals, public transport as well as air travel. However, a transitional period until 2 April allows federal states to still apply stricter measures in line with the former Infection Protection Act and gradually amend federal state legislation accordingly to the new national standard. Afterwards, stricter local regulations can only apply if the local infection situation requires it according to legislation taken by the respective federal state parliament.
<b>France</b>	The vaccine/health pass was suspended on 14 March, except for hospitals where a health pass is still required. Wearing masks remains mandatory on public transport for people aged 6 or over. Finally, vaccination remains required for health care workers.
<b>Italy</b>	Italy implements a strict "super green pass" whereby unvaccinated people cannot participate in most social events and there is a mandatory vaccine requirement for several professions (health, education, military, public facing jobs, over 50s). PM Draghi said recently that the state of emergency will not be renewed beyond 31 March, which could mean most restrictions being dropped.
<b>Spain</b>	Recently, most of the additional restrictions adopted at the regional level have been dropped with no region requiring the "COVID-19 health pass" and only Cantabria and the Canary Islands maintaining some limits on nightlife.
<b>UK</b>	There are no remaining restrictions relating to COVID-19 in England or Northern Ireland. In Scotland, some rules were lifted on 21 March, but mask wearing in some public places will remain mandatory until April, after a planned relaxation was delayed. In Wales, all remaining rules – i.e. mask wearing and self-isolation for positive cases – are set to be removed on 28 March "if the current public health situation remains stable".

Source: Country data, HSBC.

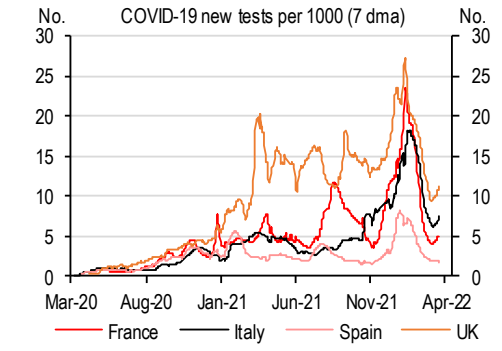
We acknowledge the assistance of Yash Dewan, HSBC Bank plc, in the preparation of this report.

## Cases up, public concern and testing down

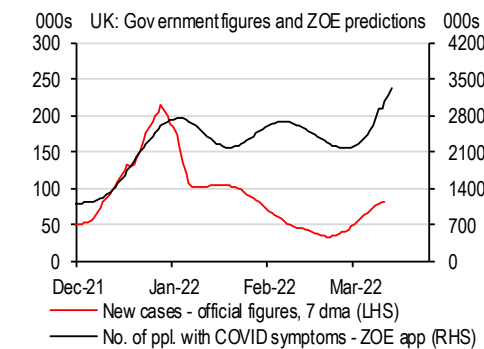
### 5. 1 in 10 UK citizens believe life has returned to normal...



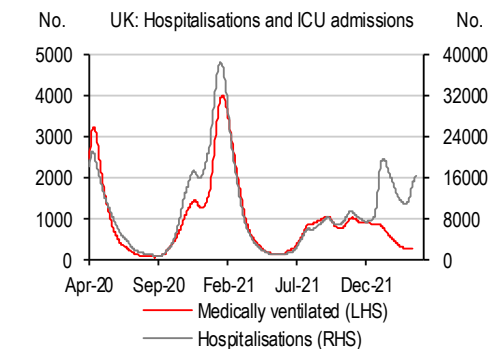
### 6. ...and testing has significantly decreased there, along with other nations



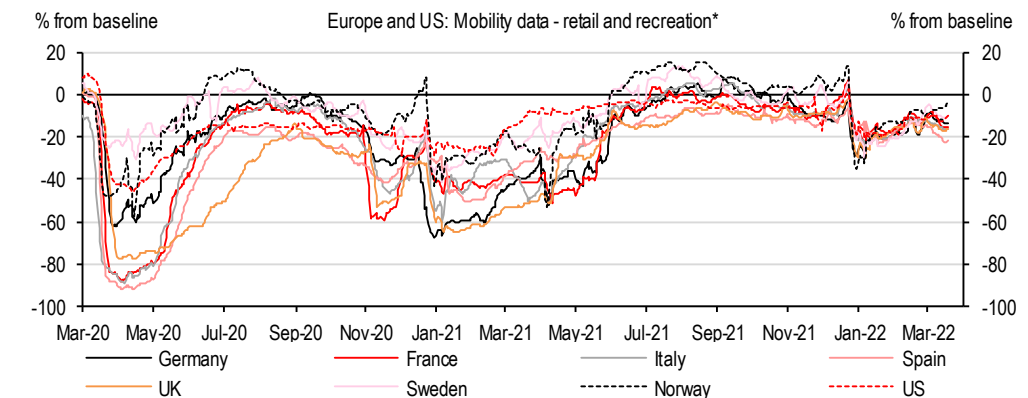
### 7. Consequently, official case estimates may be far from actual numbers...



### 8. ... which increases health risks, though ICU admissions remain low relative to rising hospitalisations

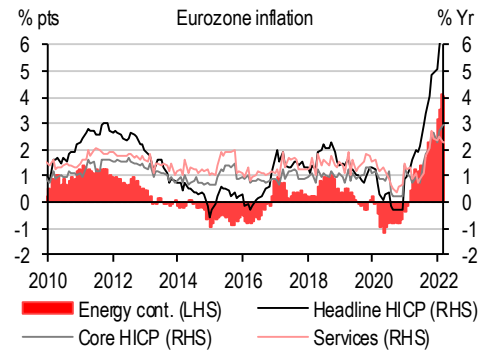


### 9. Retail and recreation mobility still remains below pre-pandemic levels

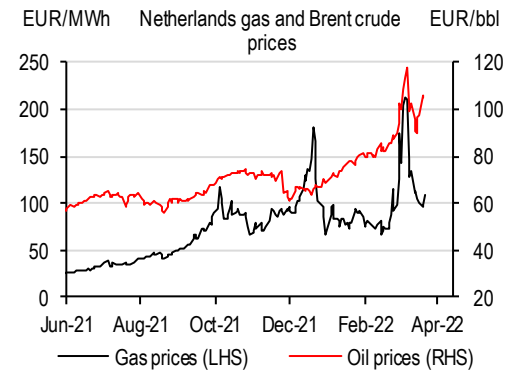


## Price pressures continue to increase

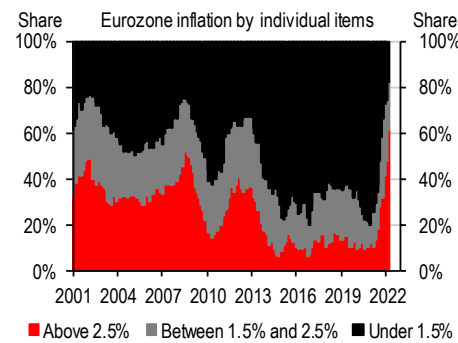
### 10. Eurozone inflation was 5.9% y-o-y in February, driven up by energy prices



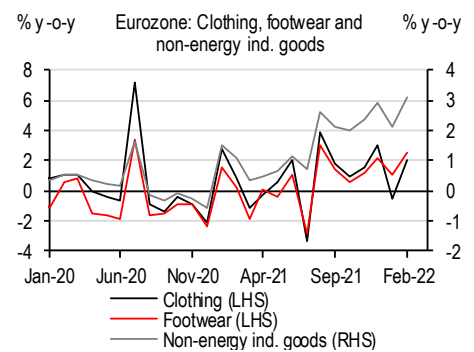
### 11. While gas prices have eased further, oil prices are on the rise again



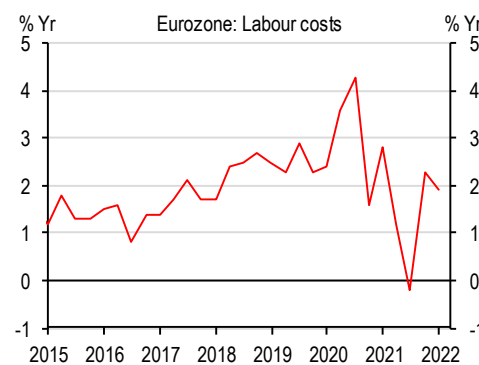
### 12. Inflation is broadening out with more items seeing higher levels of inflation...



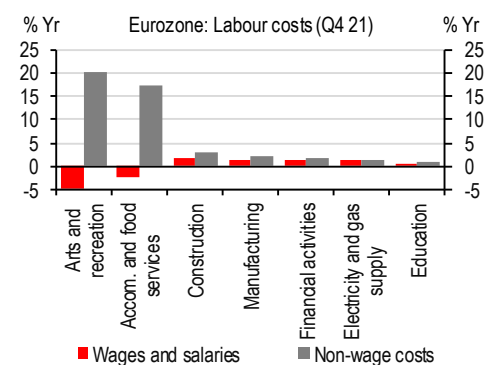
### 13. ... including clothing, footwear and other non-energy industrial goods



### 14. However, there seem to be no signs of second-round effects yet in the eurozone...

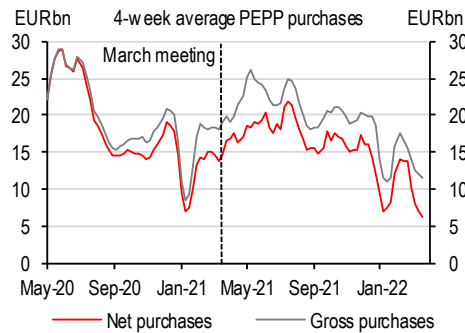


### 15. ...with limited increases (and in some sectors, even decreases) in wage costs



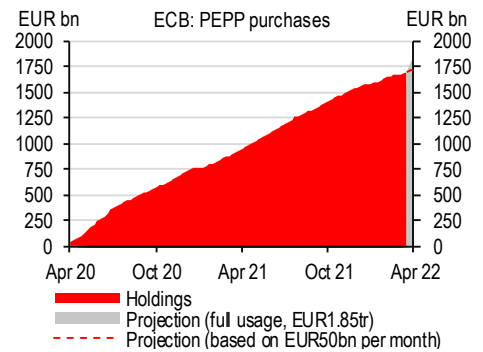
## Spreads widen as PEPP winds down

**16. The ECB is winding down PEPP and will end the programme this month**



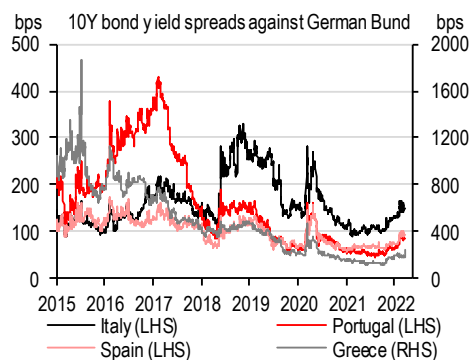
Source: ECB, HSBC.

**17. Total holdings should lie comfortably within the PEPP envelope**



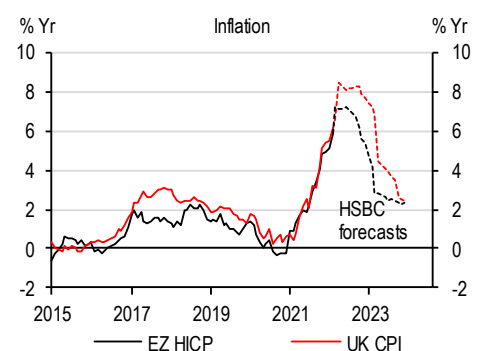
Source: ECB, HSBC.

**18. Despite announcing the end of net purchases in March, periphery spreads have not widened significantly...**



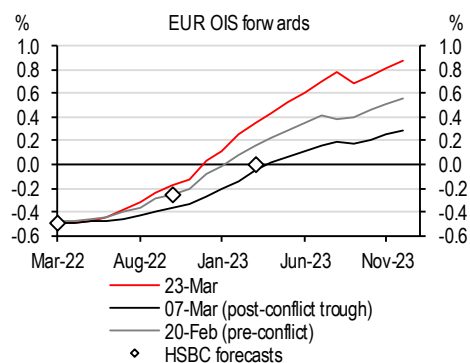
Source: Refinitiv Datastream, HSBC.

**19. ...and with inflation forecast to be higher for longer...**



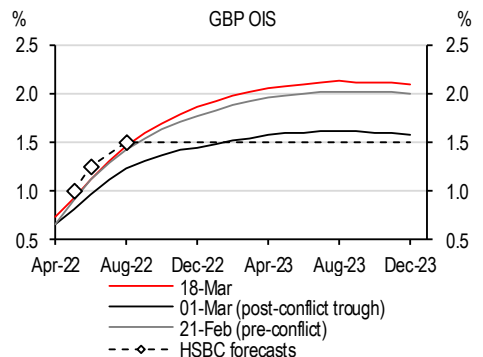
Source: Refinitiv Datastream, HSBC.

**20. ... ECB rate expectations are now more hawkish than pre-conflict levels...**



Source: Bloomberg.

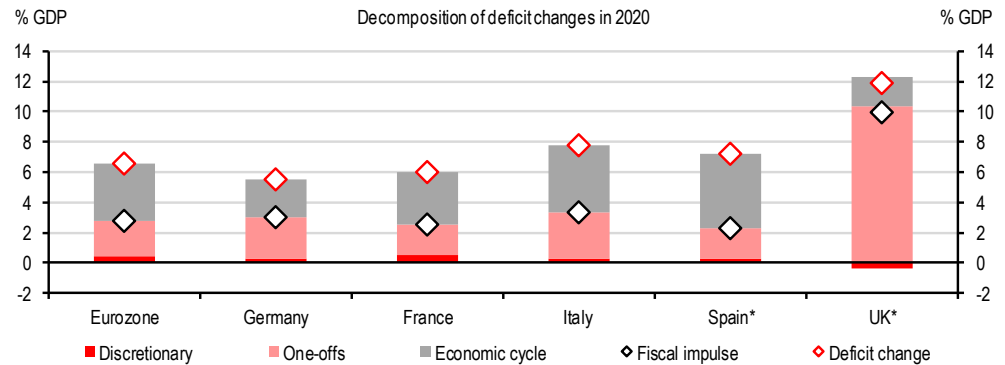
**21. ...and so are UK expectations**



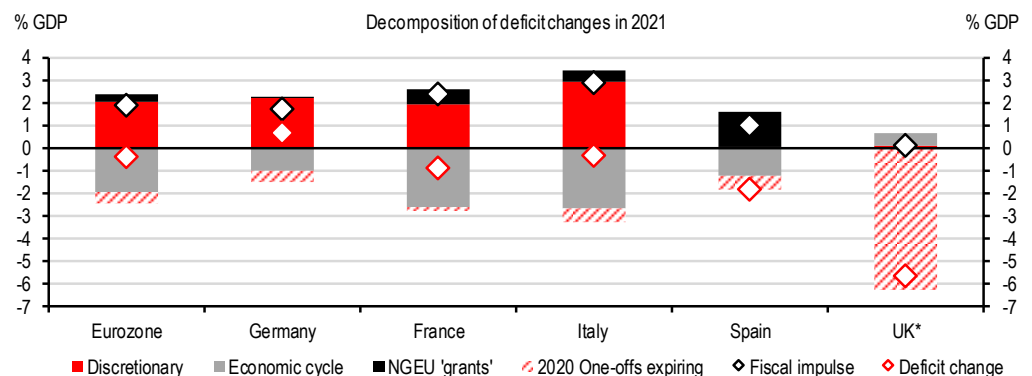
Source: Bank of England.

## Fiscal measures (in the Big 4 eurozone countries and the UK)

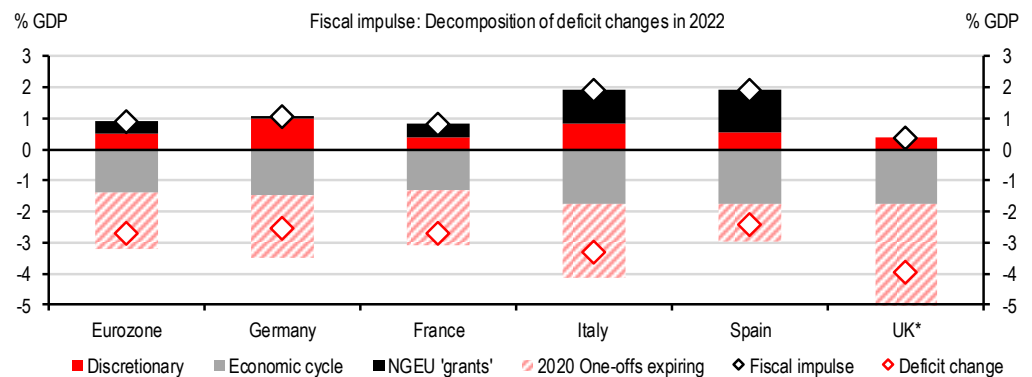
**22. Fiscal policy was highly supportive of growth in 2020 even if a significant chunk of support did not make it into the economy due to restrictions and was actually saved**



**23. Stronger-than-anticipated growth helped contain the fiscal deficits in 2021 despite a strongly expansionary fiscal policy, particularly in the eurozone**



**24. This year, the domestic fiscal policy stance should remain mildly expansionary in the eurozone, thanks also to the support provided by the Next Generation EU (NGEU) fund**



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