What Lessons for the UK as the Eurozone Dips into Recession?

Vicky Pryce

As the Eurozone shocked with the news of a technical recession in early 2023, the thoughts inevitably go on what to expect next. It is true that the EU as a whole avoided recession by growing ever so slightly(0.1%) in Q1 after a sharp 2% drop in 2022Q4 . But the Eurozone data, containing the biggest economies in the region on which many others depend needs some closer scrutiny[i].

First growth figures were revised downwards last week after an earlier first estimate suggested some small growth in the first three months of the year. This unsettled the markets that had been lulled by a European Commission upward forecast for the currency zone in May, which suggested more resilience in the economy than earlier thought likely. A milder winter had protected the region from the longer impact of higher oil and gas costs following the war in Ukraine. In fact energy prices were falling over the autumn and winter quarters under consideration. A number of Southern European countries are basking in an early pick up in tourism numbers. Labour demand continues to surpass expectations with the unemployment rate down to the lowest on record, way better than even pre-pandemic levels. What was there not to be optimistic about?

But underneath all this, the post Russian invasion problems appear to lurk deep. The globe is expanding only slowly as the latest World Bank and OECD forecasts suggest, with the outlook for 2024 worsening on the back of a more sustained period of high interest rates needed to control energy and food prices-induced inflation. Trade wars are accentuating- witness more sanctions against Russia by the EU and the G7 announcing intention to 'de-risk' from China dependence. Although goods input prices are falling and supply chain issues are easing, the toll on industrial production has been significant. Germany has led the drop in GDP in the Eurozone in Q1 as manufacturing output fell and exports were negatively affected by an only weakly recovering China. But other countries also saw declines in the first quarter. They surprisingly include small falls in Greece and the Netherlands and also a big drop in Ireland's GDP by 4.6%, though this seems to be more linked to a strange pattern in exports and imports of multinationals based there.

But the overall trend is one of a more cautious consumer still facing higher prices and also, after the massive fiscal support required during Covid, reductions in government spending. Latest monthly trends in Europe suggest that though some countries continue to outperform, economic sentiment remains subdued. If interest rates stay on their upward trend, as is quite likely with a further 1/4% hike by the ECB on June 15, the difficulties for households and businesses will continue. Credit conditions have been tightening for a while. And one cannot forget how the ECB raised rates twice in 2011, not recognising that the economy was already in recession. It had to quickly change course but years of stagnation and even deflation followed.

We are not exactly in the same place now. But the UK itself is not immune, far from it. Manufacturing has been in recession since last August and services only started growing again in the last four months. As the British Chambers of Commerce (BCC)have just warned is that the small 0.3% growth figure for 2023 could easily prove too optimistic. And yet as am writing this the markets are now pricing in 4 more one quarter point increases in interest rates between now and the end of the year as inflation has slowed down much less fast in the UK compared with the EU and the US. Longer term UK government bond yields on which fixed mortgage rates are set have adjusted upwards accordingly[ii].

Higher interest rates are not only affecting mortgage affordability but also accentuating the current cost of living crisis. A further rise in business borrowing costs hardly augurs well for growth or frankly for inflation as those extra costs may well result in businesses passing them through as higher prices for consumers.

As I myself commented on the BCC forecast release:' with anaemic growth rates predicted into the future, there is a real danger of slipping back into recession territory at any point'. The next Bank of England MPC meeting on June 22, a day after we hear what the official inflation rate was in May, will therefore be one to watch.

Vicky Pryce is a board member of the Centre for Economics and Business Research, Visiting Professor at BCU and King's College, London and on the Economic Advisory Council of the BCC.

---

[i] https://www.reuters.com/markets/europe/euro-zone-slips-into-recession-after-german-revision-2023-06-08/#:~:text=BRUSSELS%2C%20June%208%20(Reuters),the%20region's%20future%20growth%20prospects.

[ii] https://www.theguardian.com/money/2023/jun/12/uk-mortgage-turmoil-continues-as-santander-pulls-deals-for-new-borrowers