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EUROZONE GDP: LIKELY TO GET WORSE BEFORE IT CAN GET BETTER

Berenberg Macro Flash

A very serious hit: Eurozone real GDP contracted by 3.8% qoq in Q1 as harsh measures to contain the Covid-19 pandemic in most parts of the currency area crippled activity from the second half of March onwards, roughly in line with our expectations of -3.4% qoq. It is the worst performance since Eurostat started to track growth for the Eurozone in 1995 and probably the worst for the weighted aggregate of the member states that constitute the Eurozone since WW2. Due to just one very bad month, March, quarterly real GDP dropped faster than in the worst quarter of the financial crisis with -3.2% qoq in Q1 2009 (see Chart 1). The collapse erases more than 3 years of growth and brings an abrupt end to almost 7 years of unabated expansion (see Chart 2).

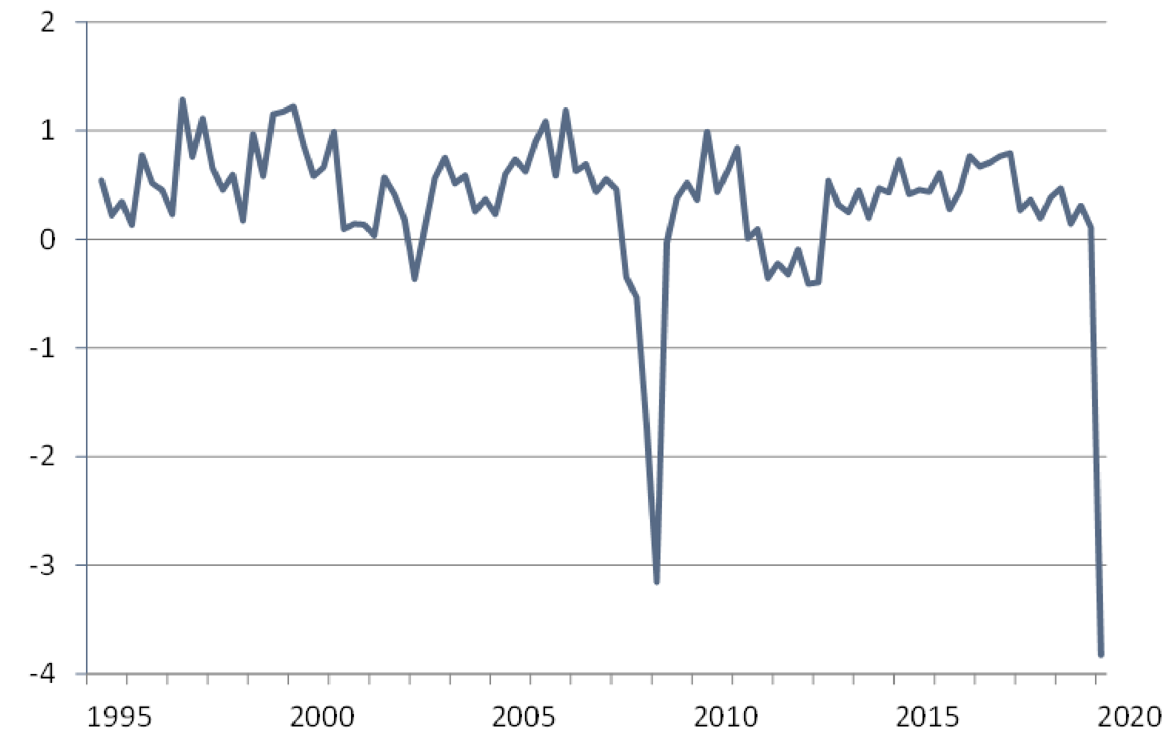
Biggest drops on record for most economies: After Q1 GDP data for Belgium (published yesterday) came roughly in line with expectations at -3.9% qoq, and Austria surprised a little to the upside (-2.5%), data out today for the second, third and fourth biggest Eurozone economies disappointed. All reported their worst declines in GDP since official series began (1949 for France, 1981 for Italy and 1970 for Spain). French GDP collapsed by 5.8%, Italy by 4.7% and Spain by 5.2%. These three countries were hit early and remain the worst affected by the pandemic in terms of total cases and deaths, in absolute numbers and per capita terms. They have, or had, the most numerous and stringent lockdown measures. In the case of Spain and Italy, their big dependence on summer tourism contributes to significant downside risk going forward. In addition, relative to the likely hit, their fiscal response is smaller than that of Germany and some other Northern European countries. That the Q1 GDP number for the Eurozone is significantly less bad than that for France, Italy and Spain suggests that GDP in Germany and other Northern Eurozone economies may have held up a little better than expected. But even for these countries, the Q1 data will still be very weak. Germany reports its first Q1 GDP estimate on 15 May.

Pandemic and lockdowns make current recession very different from previous downturns: Eurostat does not provide an expenditure-based breakdown of the GDP data until the third reading (published on 9 June). Surveys and the already published national GDP data indicate that the shock is as broad-based as it is sharp. It affects every type of expenditure (consumption and investments), sector (businesses and households) and industry (services, manufacturing and construction) – with only a few exceptions such as government expenditures, health care and food retail. Survey data for activity (Markit's PMIs) and confidence (European Commission's economic sentiment) also suggest retail and other services suffer more from the lockdown/"lock-in" measures than manufacturing and construction. The French national data in addition show that household consumption is falling by as much as business investment once adjusted for past volatility and average growth.

Bad April – slow upturn from May onwards: The Q1 decline in real GDP is probably only a fraction of the Q2 drop. In most countries, Q1 included two weeks of a harsh lockdown (second half of March). Q2 has started with a full month of such restrictions in most countries. We expect GDP to decline by c11% qoq in Q2. In some countries, restrictions, such as shops' and factories' closures, will not be lifted before May. Still, with luck, April will be the worst month. We expect a modest snap-back in economic activity as soon as lockdown measures are lifted – in some countries that is already the case (think Germany, Austria and Spain).

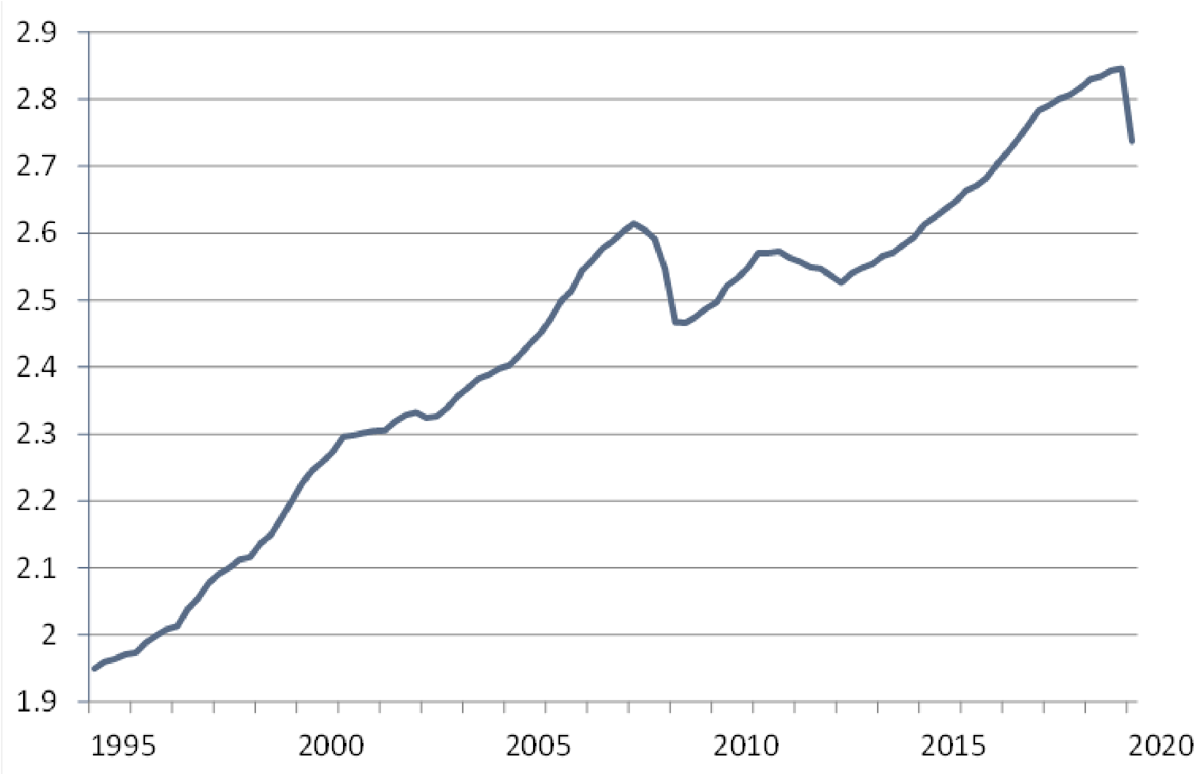
On track for tick-shaped recovery: The progress in gradually lifting some of the most economic significant restrictions, such as allowing non-essential businesses like general retail to open, remains tentative and subject to potential reversals. A sense of anxiety that lasts until the virus is defeated could continue to weigh on consumer demand and business investments for a while to come. However, the current progress remains in line with our underlying assumptions for a tick-shaped rebound in the Eurozone – that is, the current sharp downturn will be followed by a somewhat flatter upturn that ultimately goes beyond the pre-corona level of GDP some two years after the trough.

Chart 1: Eurozone real GDP growth (qoq, in %)



Source: Eurostat, Berenberg

Chart 2: Eurozone real GDP (in trn euros, 2015 prices)



Source: Eurostat, Berenberg

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