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EUROZONE GDP: STEADY GROWTH AT A SATISFACTORY PACE

Berenberg Macro Flash

Steady as she goes. Largely shrugging off concerns about Brexit and other political risks, the Eurozone economy expanded by 0.34% qoq in Q3, roughly in line with the 0.3% qoq consensus and slightly above the 0.29% qoq pace of Q2. Although Eurostat did not provide any further details with its flash estimate, the available Eurozone data for July and August and some national data point to broadly balanced growth in Q3: further gains in private consumption, government spending, business investment and – probably – exports all contributed to the expansion of demand. Despite the Brexit uncertainty, the quarterly annualised rate of growth of 1.4% came within a whisker of the Eurozone's underlying trend rate of 1.5%. Looking ahead, we expect a similar pace of growth for Q4 followed by slightly firmer gains in 2017. In Q4, uncertainty about the Italian referendum on 4 December and other political concerns may still keep growth slightly below the 1.5% trend rate in Q4. However, the strong bounce in Eurozone economic sentiment to 106.3 in October, well above the 104.3 average for the two preceding quarters, indicates an upside risk to our call. Whereas domestic demand is on track for a steady expansion, the export outlook seems to be brightening. Although the trade-weighted euro exchange rate has appreciated by 4.4% since the Brexit vote largely because of the drop in Sterling, stronger overseas demand outweighs this small loss in price competitiveness for Eurozone producers. In addition, a suitably accommodative monetary policy and a small fiscal stimulus of 0.1-0.2% of GDP will continue to underpin domestic demand.

GROWTH OUTLOOK: HEADWINDS AND TAILWINDS

The tailwind from cheap oil is fading. Having advanced to an average growth rate of 1.8% yoy in the four quarters to mid-2016, private consumption will likely decelerate to a 1.4% gain in late 2016 and 2017. However, this should be offset by the fading of two headwinds that had blown in late 2015 and early 2016: declining net exports caused partly by the crisis in emerging markets subtracted 0.3 percentage points from quarterly GDP in Q3 and Q4 2015, followed by an inventory correction of roughly half that magnitude in the first half of 2016. As both the special head- and tailwinds are no longer blowing strongly, the Eurozone should continue with a mediocre but broad-based economic upswing close to its trend rate of 1.5%. As long as the political risks do not materialise too badly (no early new elections in Italy, for instance; no US trade war with China after the US elections), Eurozone growth will likely hover around a 1.5% qoq annualised pace in 2017. As this growth goes along with a steady increase in employment, we consider this pace quite satisfactory. Short of a sweeping labour market reform in France, the Eurozone won't be able to achieve much more on a sustained basis. Could Juppe deliver such a French reform next year? Let's discuss that after the French Republican primaries on 20 and 27 November.

ECB OUTLOOK

At 0.34% qoq, the Q3 flash estimate falls slightly short of the ECB's 0.4% projection. At its December meeting, the ECB may have to lower its somewhat optimistic GDP call marginally from 1.6% to 1.5% for 2017. Even if the ECB uses this to nudge down its 2018 inflation projection, say from 1.6% to 1.5%, the change would be miniscule. In addition, the ECB's first projection for inflation in 2019 to be published in December 2016 should be roughly 1.8% on a gently rising slope for inflation. That would be close enough to the ECB's aim of "below but close to 2%". Marginal revisions to the outlook for growth and inflation plus an expectation that it will take slightly more than two years to get close to the inflation target again will probably justify an extension of the ECB's monetary stimulus beyond March 2017. But the case to do so would not be strong. In fact, trying to avoid disruptions which could come from a sudden scaling down of asset purchases could be the major reason to go about it rather gently.

We expect the ECB to announce in December that it will prolong its current €80bn asset purchases by at least 3 and more likely by 6 months beyond March 2017. To find sufficient paper to buy, the ECB will likely make some technical adjustments to the eligibility criteria for its purchases without venturing into new assets classes such as bank bonds or equities. As discussed repeatedly in recent months, we expect the ECB to start to taper its purchases in the second half of next year. In the absence of serious inflation pressures, the ECB can afford to move very gradually when it finally begins to scale back its stimulus.

POLITICAL RISKS

The risk to our outlook are obvious. A major shortfall in growth in the US, China or key emerging markets would hit the export-dependent countries of core Europe hard. Even more so, political risks loom unusually large in the US as well as in Europe. Fortunately, risks are just risks. They often do not materialise – or they may become manageable if markets discuss them well in advance.

For a discussion of these political risks, see our recent messages:

- German politics: The rough road ahead for Merkel
- Assessing the Italian risk
- The message of the polls: political risk update

EUROZONE GDP GROWTH

	Q3 16	Q2 16	Q1 16	Q4 15	Q3 15	Q2 15
qoq	0.34	0.29	0.51	0.45	0.34	0.37
yoy	1.6	1.6	1.7	2.0	2.0	2.0

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