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EUROZONE RECOVERY GAINS TRACTION

Berenberg Macro Flash

Eurozone GDP, Q1 (qoq, in %)

Actual:	**0.5**
Previous:	0.5
Consensus:	0.5
Berenberg:	0.4

The Eurozone recovery is broadening, firming and becoming more resilient: The Eurozone economy expanded by 0.5% (0.46%) qoq in Q1, in line with consensus expectations and at a similar rate as in Q4 (revised up last week from 0.4% to 0.5% qoq). In a year beset with serious political risks, the economy got off to an encouraging start. With major uncertainties from elections this year out of the way (Wilders in Netherlands) or – hopefully – receding (Le Pen in France, early elections in Italy), the upswing is poised to maintain its current momentum or even gain further traction in the quarters to come. This is good news for the Eurozone which needs further years of economic recovery and political stability to bring down the still elevated rate of unemployment that is fuelling populist sentiment.

The Eurozone's recovery broadens across countries: Eurostat's advance reading of GDP (first of three releases) does not provide details on a country-by-country basis. Country readings published by national institutions so far sent mixed signals. While Spain surprised on the upside (0.8% qoq instead of 0.7% expected and previously), France met our expectations (0.3%, after 0.4% in Q4) but fell short of the consensus estimate of 0.4%. In Belgium activity accelerated in Q1 to 0.5%, after GDP growth during Q4 was revised down from 0.5% to 0.4%, while Austria reported a rate of expansion of 0.5%, a notch below the previous quarter's rate (0.6%). Germany and Italy will report their first readings on 12 May and 16 May, respectively. We expect growth in Germany to have accelerated (0.7%, after 0.4% in Q4), while remaining unchanged in Italy (0.2%). Considerable differences remain in the Eurozone with annualized rates of GDP growth ranging from 0.7% (Italy) to 3.1% (Spain) in Q1. But the upswing is gathering pace across the currency union, with GDP expanding in all countries of the Eurozone except Greece and Finland.

Recovery broadens to all pillars of demand: While today's GDP reading does not disaggregate the overall growth rate, we expect the details to show a broadly balanced growth with all major pillars of domestic demand contributing to growth. Surveys and data from some Eurozone member countries point that way. The improving labour market drives private consumption. Unemployment, while still elevated at a rate of 9.5% in March compared to the current sub-5% rates in the US and UK and the sub-8% rates before the financial crisis in the Eurozone, has come down from a peak of 12.1% in April 2013. Employment gains, and to some extent first signs of wage increases, raise disposable incomes, confidence and household spending. Private consumption, however, does not need to do the heavy lifting alone as more support comes from business investment and government consumption – the disaggregated French GDP numbers confirmed that last week. Fiscal budgets rebalance as outlays for unemployment benefits drop while tax revenues are increasing. As a consequence, countries can afford to loosen their fiscal stance slightly. Businesses continue to benefit from very favourable financing conditions at zero interest rates. As they face more demand, with backlogs of work rising despite higher levels of employment according to the PMI surveys, they are starting to believe in a lasting upswing and invest in bigger, longer-dated purchases. Demand not only comes from the Eurozone, but also from abroad, as the recovery gains traction globally and the euro remains competitively valued (the euro on average was down by -1.3% versus the US dollar in Q1 compared to Q4 and -3.4% versus Q1 2016).

A broad recovery means a more resilient recovery: ECB president Mario Draghi, in his press conference last Thursday, stressed that the days, or rather years, when the recovery was "fragile and uneven" – a characterization he used for the economic environment during 2013 and 2014 – were gone. We agree. With the upswing gaining traction in most Eurozone countries and all pillars of demand, the risk of a shock derailing it has fallen.

More in the tank – recovery may gain momentum. Soft data picked up considerably in Q1, with the PMI and the Economic Sentiment Index reaching multi-year highs – including forward-looking components such as new orders and 12-month optimism. GDP growth did not accelerate in a similar fashion. We thus have to take the current levels of the soft data with a pinch of salt. Although business and consumer surveys may exaggerate the improvement, the economic fundamentals are positive and strengthening. We expect the economy to expand at a rate between 0.4% and 0.5% qoq, with a chance that growth may surprise to the upside as long as none of the major political risks materialises. Businesses and consumers may feel confident enough to spend and invest a little more in the fourth year of the expansion than they have done so far. Some spillovers from a fiscal stimulus in the US in late 2017 and a greater chance that structural reforms in France will raise trend growth in France and the Eurozone could add to the positive outlook. All in all, economic fundamentals and the current news flow bode well for the currency union which needs continuing economic growth to bring more people into jobs and stabilise the political discourse.

All in all, the outlook is now even more positive than we had expected in our Year Ahead assessment in early January.

Today's reading does not change the inflation outlook and should thus not affect the monetary policy stance. The ECB is projecting 1.8% growth for 2017. Today's release is in line with that. As slack is absorbed, underlying inflationary pressure should build over time. However, the speed at which idle resources are utilised again remains gradual. Core inflation will thus pick up only slowly. For that reason the ECB will pursue its monthly asset purchases until December 2017 as planned. We expect the Governing Council to shift its outlook for risks to growth from downside to balanced in June and to announce later this year a tapering of asset purchases from January 2018 onwards.

Eurozone GDP (in %)

	Q1 17	Q4 16	Q3 16	Q2 16	Q1 16	Q4 15
qoq	**0.5**	0.5	0.4	0.3	0.6	0.4
yoy	**1.7**	1.8	1.8	1.6	1.7	2.0

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