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EUROZONE ON TRACK FOR A SOLID 2018 AFTER STRONG Q4

Berenberg Macro Flash

Eurozone GDP, Q4 2017 (qoq, in %)

Actual:	0.6
Previous:	0.7
Consensus:	0.5
Berenberg:	0.6

The best year in a decade: The Eurozone rounded off last year with its 19th consecutive quarter of growth. According to a first Eurostat estimate, GDP expanded by 0.56% qoq – the 5th quarter of at least 0.6% qoq growth – after a slightly upward revised Q3 of 0.7%. The Eurozone has come a long way. Five years after the ECB defused the euro crisis in mid-2012, the economic upswing across the Eurozone accelerated from an annual pace of 1.8% in 2016 to 2.5% in 2017 – the highest in a decade. This compares to growth of 2.3% in the US and 1.8% in the UK. The strength of the Eurozone recovery was the great surprise of 2017. Mounting momentum at home and a healthy global upswing can keep growth well above the 1.5% trend rate despite a stronger euro. In the foreseeable future, the expansion is unlikely to hit inflationary bottlenecks or fuel excesses that would require a cleansing correction. The ECB does not, therefore, need to exit its monetary stimulus prematurely. An expansion at well above trend allows the ECB, however, to stop purchasing assets after September 2018 and to start the rate cycle in Q1 2019.

Growth momentum remains strong despite a small dip in Q4: While today's GDP reading does not disaggregate the overall growth rate, we expect the details to show a broadly balanced growth with all countries, sectors and pillars of demand contributing to growth. Hard and soft data for the quarter point that way. French and Spanish GDP readings this morning confirmed expectations of a continued solid expansion (0.6% qoq in France, after 0.5% in Q2; 0.7% in Spain, after 0.8% in Q2). Consumption, a key driver of demand, likely contributed to growth, but probably less so than in the previous quarter – similar to the French GDP reading. Employment gains raise disposable income, confidence and household spending. But higher pump prices of 2% in Q4 qoq may have weighed on some households' pockets. Retail sales were only up by 0.1% when comparing the average of October and November with Q3. Business investment probably expanded strongly – industrial production was up by 1% qoq based on the average of October and November compared with Q3. Businesses benefit from the low interest rates and positive global environment. Activity among manufacturers shows a clear upward trend – capacity utilisation rose to 84.4%, the highest level since Q3 2007 according to today's Economic sentiment index (ESI). Supply constraints are replacing lack of demand not only in countries at an advanced stage in the cycle, another insight from the ESI. Stronger foreign demand has offset the recent loss of cost competitiveness amid a stronger euro. Overall, exports and imports probably expanded at a similar pace in Q4, with foreign trade thus neither weighing on nor contributing positively to GDP growth in Q4.

Gradual return to normal in 2017: The major underlying theme of the broad-based recovery across all countries, sectors and pillars of demand is a gradual return to normal. Following the double whammy of the financial crisis of 2008/09 and the euro crisis of 2011/12, the region had languished in an age of caution from 2013 to 2015. From the second half of 2016, companies and households have turned more confident: they dared to invest, spend and borrow a little more again. This continued into 2017. Last year, by defeating Marine Le Pen and introducing labour market reforms, French President Emmanuel Macron helped lift the cloud of political uncertainty and slightly also the burden of a low long-term growth rate from the Eurozone. The strong employment gains and slightly stronger wage growth offset the rise in oil prices that had otherwise caused households' consumption to fall. Also, the pick-up in global trade has turned the headwind into a tailwind with net exports contributing 0.5% to Eurozone GDP growth, even despite a stronger euro (versus the US dollar up by more than 14% in 2017).

Risks to growth outlook are tilted to the upside: The risks to our calls of 0.5-0.6% qoq and 2-2.5% yoy in 2018 and 2019 remain tilted to the upside. Leading indicators such as the PMIs or the German Ifo project even stronger growth ahead, while today's modest correction in the ESI could be a sign that the Eurozone's pace of growth of 0.6-0.7% qoq may be



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the limit. The strong euro is not holding back the economy in any significant way yet. While confidence among export-oriented manufacturers remained in January at its December peak, the reading for export orders even improved further. The Eurozone continues to ride the global upswing as well as the momentum it has generated at home.

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