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EUROZONE GDP: TEMPORARY DENT IN Q1, SOLID TREND

Berenberg Macro Flash

Eurozone GDP, Q1 2018 (qoq, in %)

Actual:	**0.4**
Previous:	0.7
Consensus:	0.4
Berenberg:	0.4

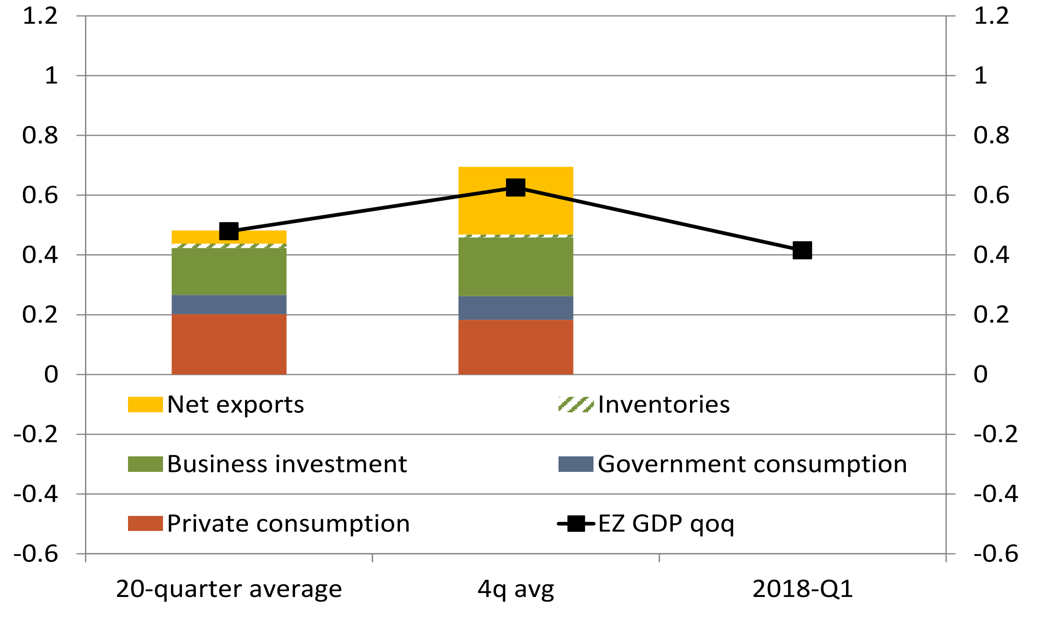
Near-term dent to growth: After accelerating to the strongest growth in a decade in 2017, the Eurozone upswing moderated in the first quarter of 2018, its 20th consecutive quarter of growth. Following four quarters of growth at an average rate of 0.7% qoq, the economy expanded by 0.4% (0.42%) in Q1 according to a first Eurostat estimate and in line with expectations (see chart 1). The question is whether this is just a blip or the beginning of a more pronounced cyclical slowdown. The truth probably lies somewhere in between. The ECB stressed last week that the underlying momentum of the Eurozone expansion remains strong and supports a gradual convergence of the currently subdued price pressures to an inflation rate more to their liking. We agree and expect the ECB to wait for a evidence that growth will regain a little extra momentum over the next months before they take any major further step towards the exit from their current policy stance (for our ECB policy outlook, see here).

Blame the weather, the flu, the euro ...: Today's GDP reading does not disaggregate the overall growth rate. Judging by disappointing data from industrial production (average of January and February down by 0.55% vs. Q4) and retail sales (-0.3%), the detailed breakdown of GDP, published with the third reading on 7 June, will likely show a slightly weaker contribution by both business investment and private consumption to overall growth. A number of one-off factors (adverse weather, unusually high number of flu cases) have weighed on activity in Q1. The stronger euro, which rose by 6.3% in 2017 in trade-weighted terms, cost Eurozone exporters some market share and has compressed their margins. The contribution from trade will, therefore, also be limited. Net exports may even have been a small drag on growth in Q1.

... and, of course, the trade tensions: Meanwhile, fears of protectionism stoked by US President Trump have weighed on sentiment, with not only the forward-looking sub-indicators suffering a hit (ESI, PMI, German Ifo). Combined with the stronger euro, the less euphoric confidence will likely restrain investment intentions at a moment when businesses ought to expand their capacities to accommodate higher demand. Capacity utilisation is high (according to the ESI: 84.4%) and an increasing share of businesses struggle to find new, qualified workers. According to the ESI, for the first time in more than 30 years labour is as much a limiting factor to production as demand is (see chart 2). These supply constraints suggest that businesses will not curtail production growth much in response to a temporary dent in demand as they have a cushion of orders to fill.

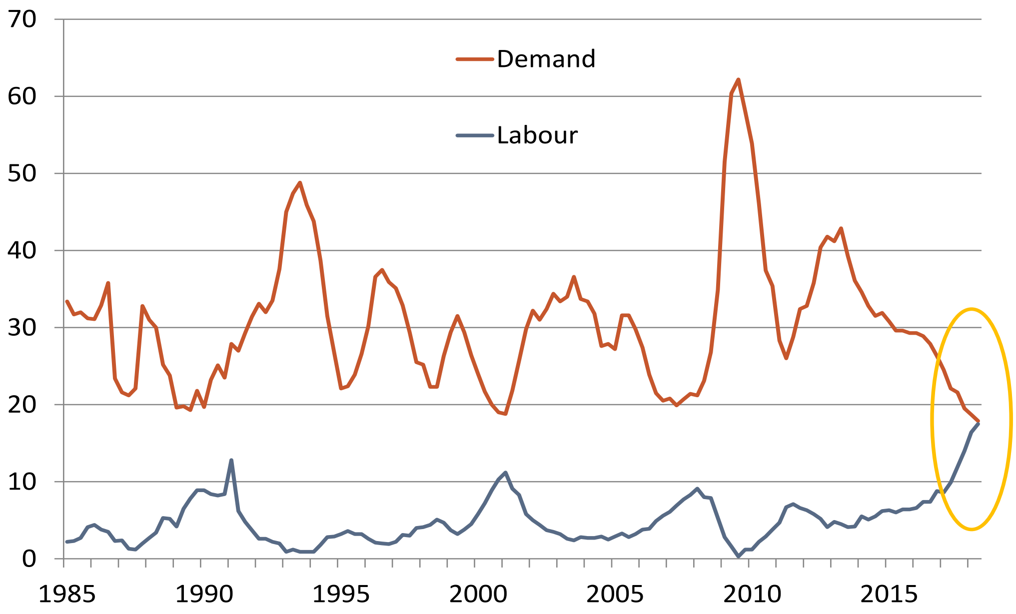
Some bounce back in the short-term, moderation over the medium-term: Ultimately, we expect some Q2 bounce back from the exceptional factors that hit output in Q1 and a general rebound in activity in H2 as trade tensions ease. We look for the US looks to strike deals with its trading partners including the EU. In addition, the euro has come well off from its highs (1.20 vis-à-vis the US dollar now after 1.25 in mid-February). Sentiment, at least the assessment of the current situation, remains at a high level. Still, the acceleration phase of the upswing is over in the Eurozone and the highest quarterly growth rates lie behind us. After growth at a rate well above-trend (2.5-3% vs. 1.5%) for more than a year supply constraints limit the rate at which demand can expand. Over the medium-term, some moderation is likely to growth rates that remain above the 1.5% trend, but less so than in 2017. More precisely, we expect rates of growth of 0.5-0.6% qoq/2.3% yoy in 2018 and 0.5% qoq/2.2% yoy in 2019 (see chart 3).

Chart 1: : Contributions to Eurozone GDP growth (qoq, in percentage points)



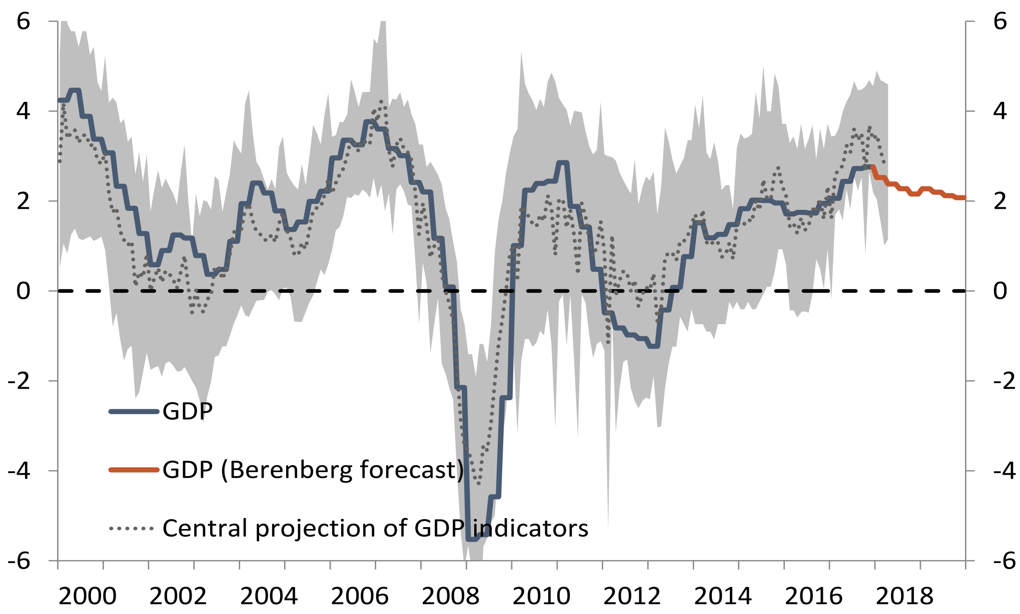
Contributions to GDP growth in percentage points. No breakdown for Q1 2018. Source: Eurostat

Chart 2: Limiting factors to production



The answers "labour" and "demand" refer to the European Commission's economic sentiment survey's question of what limits the production of manufacturing companies. Source: European Commission

Chart 3: GDP growth (yoy, in %), Berenberg forecast and range of GDP indicators



Quarterly data for GDP, monthly data for leading indicators. Yoy GDP growth in %. Range of leading indicators is normalised and then rebased using standard deviation and mean of GDP growth. Sources: Eurostat, ECB, European Commission, Ifo, Markit, Berenberg calculations

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