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EUROZONE GDP: A QUARTER TO FORGET

Berenberg Macro Flash

Eurozone GDP, Q3 2018 (in %)

	qoq	yoy
Actual:	**0.2 (0.16)**	**1.7 (1.66)**
Previous:	0.4	2.2
Consensus:	0.4	1.8
Berenberg:	0.3 (0.26)	1.8 (1.77)

The Eurozone economy recorded its 22nd consecutive quarter of growth in Q3. It was nothing to celebrate, though, as it was also its weakest. Having moderated already in H1 2018 after a stellar performance in 2017 (0.4% qoq on average vs. 0.7%), the upswing slowed down further to a meagre pace of 0.2% qoq (0.16%)(see chart 1). Temporary national factors (Germany's car industry, Italy's manufacturing sector) are a big part of the story, but not the only. In addition, a potent cocktail of risks held down growth in Q3, and will continue to do so in Q4. For the ECB, today's disappointing GDP print will most likely require a revision of the 2018 and 2019 projections. However, the ECB will nonetheless end asset purchases this December, in our view.

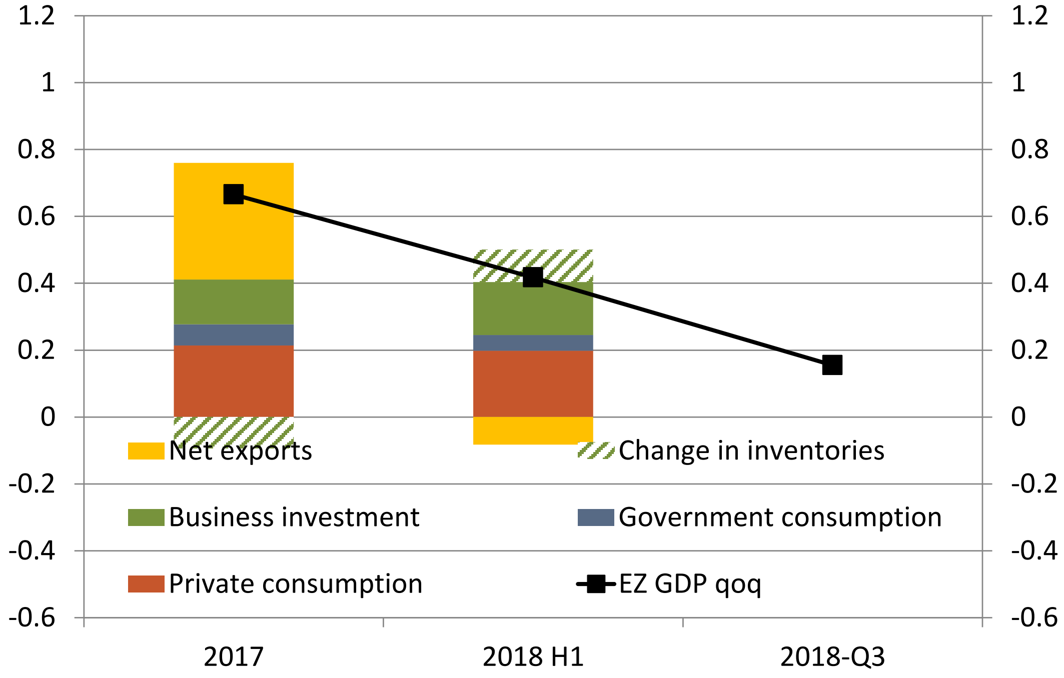
Soft private domestic demand: Eurostat's preliminary estimate does not provide a detailed breakdown by components, which will be published with the third reading on 7 December. Judging by the available hard data for the first two months of Q3, the two pillars of private domestic demand, consumption and investment were both on the back foot. Retail sales and industrial production were down by 0.3% and 0.2% qoq, respectively (comparing the July/August average with Q2). Soft data for September and national GDP data suggest any contribution to GDP growth in Q3 may have come from the services sector thanks to continued employment gains and stronger wage growth.

Temporary national factors: The industrial sector was, however, a drag to growth in Q3. Germany's car sector struggle with stricter emission testing standards (WLTP) and a close-to-standstill performance of the German economy (published 14 November, our forecast: 0.1% qoq, risk of 0.0% instead) weighed on Eurozone growth in Q3. Surprisingly disappointing Italian Q3 growth (0.0% qoq instead of expected 0.2%) added to that, with the manufacturing sector offsetting a positive contribution from services. Still 5% below the pre-crisis level vs. the Eurozone's +7% (see chart 2), stagnation is not what the debt-burdened Italian economy needs. Wishful thinking or not, the weak economic performance in Q3 and another rise in BTP yields up by 5-10ppt today may, however, have a disciplining effect on the Italian government. The Eurozone got a boost from France in Q3 where GDP growth (0.4% qoq) came in line with our expectations, while surprising the market on the downside (0.5%). After industrial action limited French economic growth in Q2, private consumption recovered, business investment continued to hold up firm and even trade contributed to growth.

Cocktail of risks weighs on Eurozone more broadly: But temporary national factors are not the whole story. The potent cocktail of risks caused a drop in sentiment and a delay of investment decisions, and will continue to do so. The chances that US-Chinese trade tensions may ease shortly have receded and the Italian noise is getting louder. As a result, we reduced our near-term forecasts for Eurozone growth last week. We now project 0.25% qoq for Q4 2018 followed by 0.35% for Q1 2019. After a period of below trend growth in H2 2018, we expect Eurozone growth to re-accelerate to a pace just above the 0.4% qoq trend rate (in annualised terms 1.5%) over the course of next year. Due to the lower starting level for 2019, average annual growth next year could come in at 1.4%. Our forecasts for late 2018 and early 2019 are below consensus, as was the case for Q3 2018.

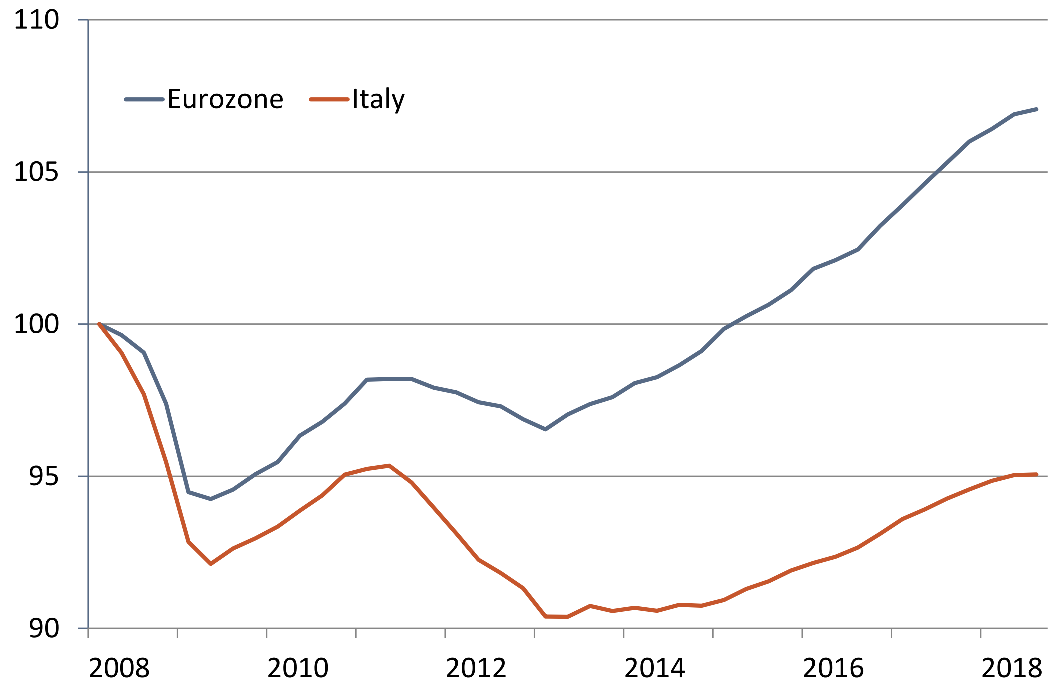
ECB impact: Last Thursday, the ECB shied away from downgrading its assessment of the risks to the economic outlook and chose to send out a message of calm and confidence. Following the Q3 print and assuming no major revisions, we expect the ECB now even more to lower its projection of 1.8% real GDP growth for 2019 GDP growth visibly at its meeting on 13 December. As the ECB is keen to end its contentious asset purchase programme, this will, however, not suffice to prolong asset purchases. Softer growth will likely trigger a debate at the ECB whether the guarantee to keep interest rates at their current record-low levels should be extended beyond the summer of 2019. The ECB need not take a decision on a potential tweak to its rate guidance in December already. It has plenty of time to watch the data. If growth rebounds from its 2H 2018 dip to an annualised rate at or above the 1.5% trend over the course of 2019, as we expect, the ECB will probably still start to raise rates very gradually next autumn.

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



Contributions to GDP growth in percentage points. No breakdown for Q3 2018. Source: Eurostat

Chart 2: Eurozone vs. Italian GDP since peak of previous cycle



Indexed at Q1 2008 = 100. Source: Eurostat

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