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EUROZONE GDP CAN SURPRISE TO THE UPSIDE

Berenberg Macro Flash

Eurozone GDP, Q1 2019 (in %)

	qoq	yoy
Actual:	**0.4 (0.38)**	**1.2**
Previous:	0.2	1.2
Consensus:	0.3	1.1
Berenberg:	0.2 (0.25)	1.0

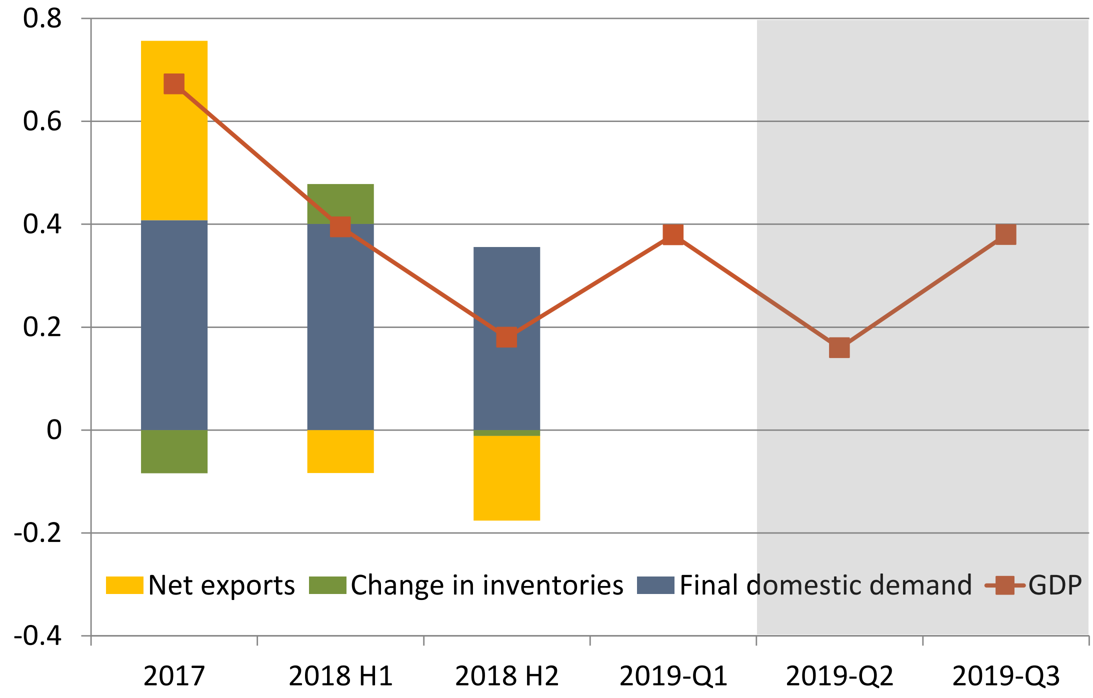
Some cheers at last: After a disappointing 2018, the Eurozone got off to a better than expected start in 2019. The strong slowdown over the course of 2018 from 2.5% in 2017 to 0.7% annualised pace on average in H2 2018 was followed by a first quarter 2019 during which growth picked up to 1.5% quarterly annualised pace according to a first Eurostat estimate, or 0.38% qoq on non-annualised data. The domestic side of the economy, especially consumption, likely did most of the heavy lifting. A little tailwind from an outsized boost from construction helped as well, reflecting both a strong trend in construction and an unusually mild winter. Beyond the weather, the late timing of Easter which shifted Easter holidays fully into Q2 may also have contributed to the good outcome for Q1. While we see near-term risks for Q2, today's GDP print supports our call that, if and when the external headwinds fade, Eurozone growth can return to its trend rate of around 1.6% annualised on a sustained basis from H2 onwards (see Chart 1).

The tale of two sectors: Eurostat does not provide an expenditure-based breakdown of the GDP data until the third reading (published on 6 June). Without the breakdown of spending, we can only go by the trends in national data, other series and surveys to judge how the underlying components may have contributed to headline growth rate in Q1. These data continue to show a widening gap between two different worlds within the Eurozone economy. The Eurozone's trade-reliant exporters of manufacturing goods are still struggling. In Q1, imports likely outpaced exports again. Industrial production probably recovered (c1% qoq) from the worrying Q4 (-1.1%), but likely remained below the Q1 2018 level. The other part of the economy that depends on domestic consumption and provides services is holding up nicely and looks almost unscathed. The Q1 GDP prints for France (0.3% unchanged from Q4) and Spain (0.7% qoq after 0.6% in Q4) point to consumer expenditures outpacing overall demand. Employment growth has slowed modestly but remains solid for now. The unemployment rate fell to a more than 10-year low of 7.7% in March as the number of unemployed persons dropped by 174k mom, bringing the fall in unemployment since March 2018 to 1,170k. Sustained gains in incomes and lower oil prices boosted households' purchasing power at the start of 2019. Eurozone retail sales may have increased yet again solidly (0.6% qoq after 0.7% during Q4).

Downside risks for Q2 …: Throughout 2018, the number of external headwinds, political risks and country-specific shocks only increased. Sentiment, especially in industry, turned ever dimmer in the Eurozone. This caused the Eurozone business cycle to slow down. The weakness in sentiment has carried over into 2019. Surveys pointed to a deepening industrial recession at the start of Q2. The upside surprise in the GDP print suggests that the situation among manufacturers may not have worsened in line with sentiment during Q1 and that domestic demand offset the likely drag from net trade. Taken at face value, this lowers the risk that the domestic economy will start to tank before industry turns the corner by mid-year. Leading indicators such as the German Ifo, Chinese and Eurozone PMIs suggest that Q2 could, however, be more downbeat than Q1 and highlight some downside risk to our near-term risk to our below-consensus call of a 0.2% qoq gain in Q2 GDP (see Chart 2).

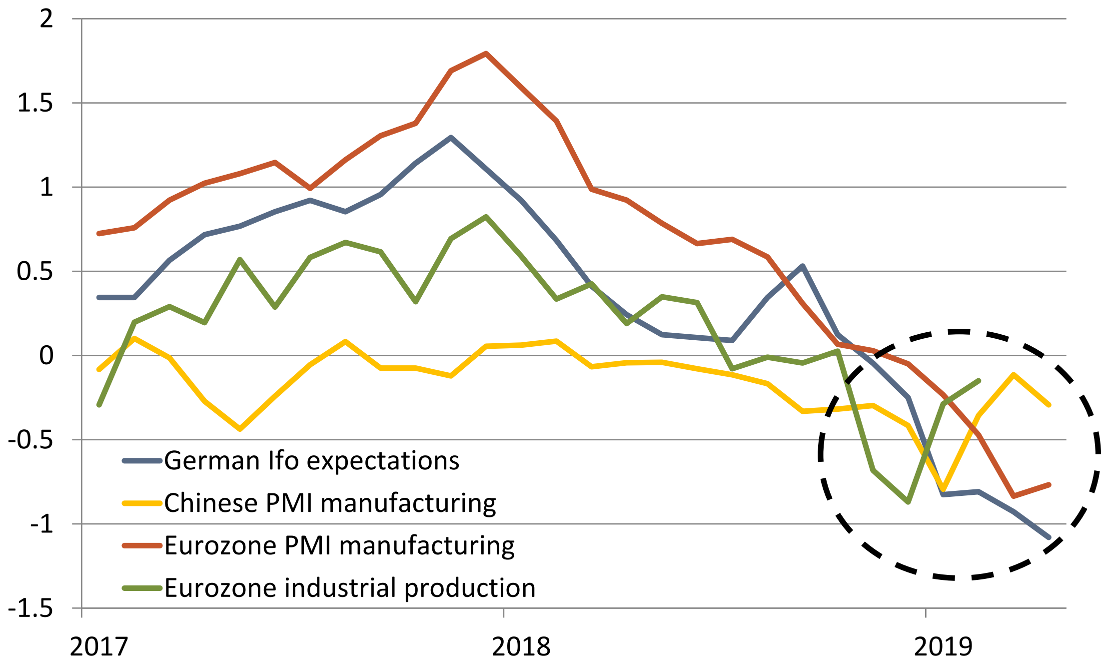
… but chances for a sustained recovery in H2: By and large, the necessary conditions for an industrial turnaround later this year are falling into place. Over the past few weeks, US-China trade tensions have eased, news from China have suggested the Chinese stimulus may have started to work and the risk of an immediate hard Brexit has receded. As a result, we still expect the recovery to start by mid-year. If and when the industrial cycle among Germany's export-reliant manufacturers turns, it could do so noticeably. The uptick in domestic activity on top of fading external burdens sees to that. We are thus more optimistic than consensus for the outlook from mid-2019 onwards. Our calls for German and Eurozone growth of 1.6% each for 2020 are above the Bloomberg consensus of 1.4% each.

Chart 1: GDP growth and its contributions to growth



Qoq GDP growth in %, contributions in %-points. No breakdown for Q1 2019 and beyond. Berenberg projections for Q2 and Q3 2019. Source: Eurostat, Berenberg

Chart 2: Mixed signals: Eurozone industrial production and key indicators



Industrial production and key indicators normalised by average and standard deviation since 2005. Sources: Caixin, Markit, Eurostat, Haver Analytics, Berenberg

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