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EUROZONE ECONOMY NO LONGER SURPRISES TO THE DOWNSIDE

Berenberg Macro Flash

Eurozone GDP, Q3 2019 (in %)

	qoq	yoy
Actual:	**0.2**	**1.1**
Previous:	0.2	1.2
Consensus:	0.1	1.1
Berenberg:	0.1	1.1

The Eurozone economy is no longer surprising to the downside. In Q3, GDP expanded by 0.2% (0.19%) qoq, unchanged from Q2 (see Chart 1). The Q3 result thus came in ahead of our call and the consensus of 0.1%. It is the Eurozone's 26th consecutive quarter of qoq growth. Significant gains in Spain (+0.4% qoq) and France (+0.26% qoq) and a small increase in Italy (0.1% qoq in Q3 after 0.0% in Q2) seem to be offsetting weaker data from Germany for the time being. While German GDP data are not yet available (first reading published on 14 November), the 0.7% drop in German industrial output in July/August relative to the Q2 average suggests that German GDP may have contracted slightly in Q3.

In year-on-year terms, Eurozone growth has decelerated from a cyclical peak of 3% in late 2017 to 1.15% in Q2 and Q3 2019. The trade-driven global downturn continues to weigh heavily on the Eurozone. However, today's GDP data support our hope that Eurozone growth may bottom out early next year. If so, this could set the scene for a return to healthier levels of growth over the course of 2020.

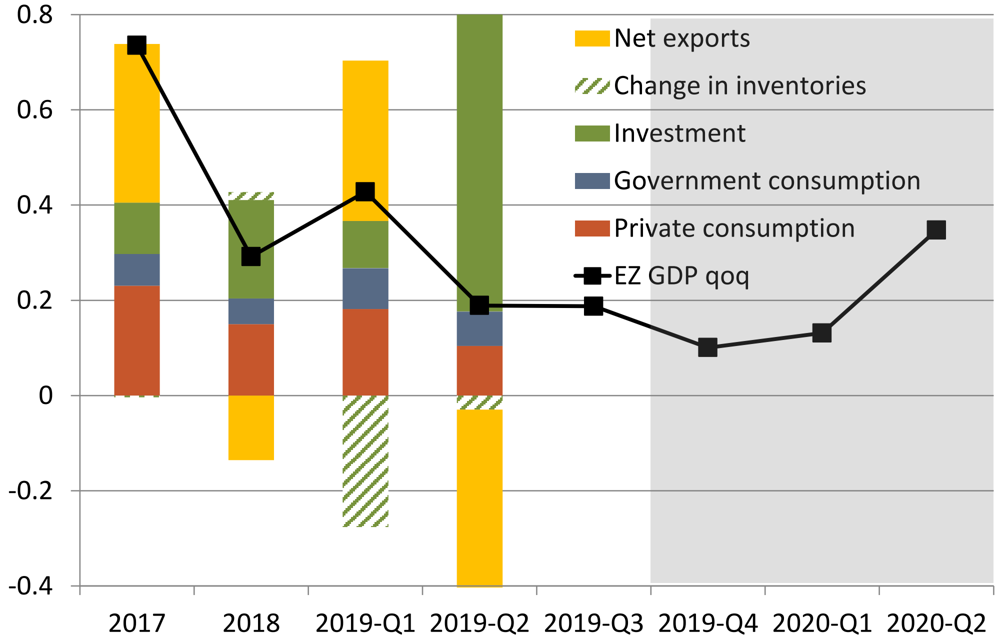
Another twist in the tale of two sectors: Eurostat does not provide an expenditure-based breakdown of the GDP data until the third reading (published on 5 December). Surveys and the few national GDP data that have already been published for Q3 indicate that the gap between the trade-oriented goods producers and domestically-oriented services is no longer widening. This has two reasons – one mildly positive, one more on the negative side.

While manufacturing continues to weaken, surveys suggest that the sector may hit a bottom soon. Industrial production fell by 1% in July/August vs. Q2 with declines across all major Eurozone economies except Spain. According to the manufacturing subindices of the Eurozone PMI, ESI and Ifo surveys for October, however, sentiment in industry has started to stabilise while activity is no longer deteriorating much further. This holds even for Germany, the country most exposed to external shocks. As a result, factory orders and industrial production could hit bottom in a few months (see Charts 2 and 3). For the time being, the Eurozone's trade-reliant exporters of manufacturing goods are still struggling, though. Based on national GDP and Eurozone trade data, imports likely outpaced exports yet again in Q3.

Services are still holding up, but cracks are emerging. Ongoing employment growth and rising wages drive gains in household disposable incomes. Low oil prices – and low inflation more generally (headline and core at 0.7% yoy and 1.1%, respectively, in October) – give a little extra boost to real purchasing power. The Q3 GDP prints for France and Spain showed that healthy domestic demand is so far offsetting the drag from trade in these countries. But Eurozone service providers are no longer escaping the industrial malaise unscathed. Most surveys of the service sector softened in September/October (see Chart 4). Job creation is slowing and some businesses have started to cut their headcount. In the Eurozone as a whole, the unemployment rate remained stable at 7.5% in September while the number of unemployed persons increased by 33k mom. Retail sales were only up by 0.1% in July/August relative to Q2.

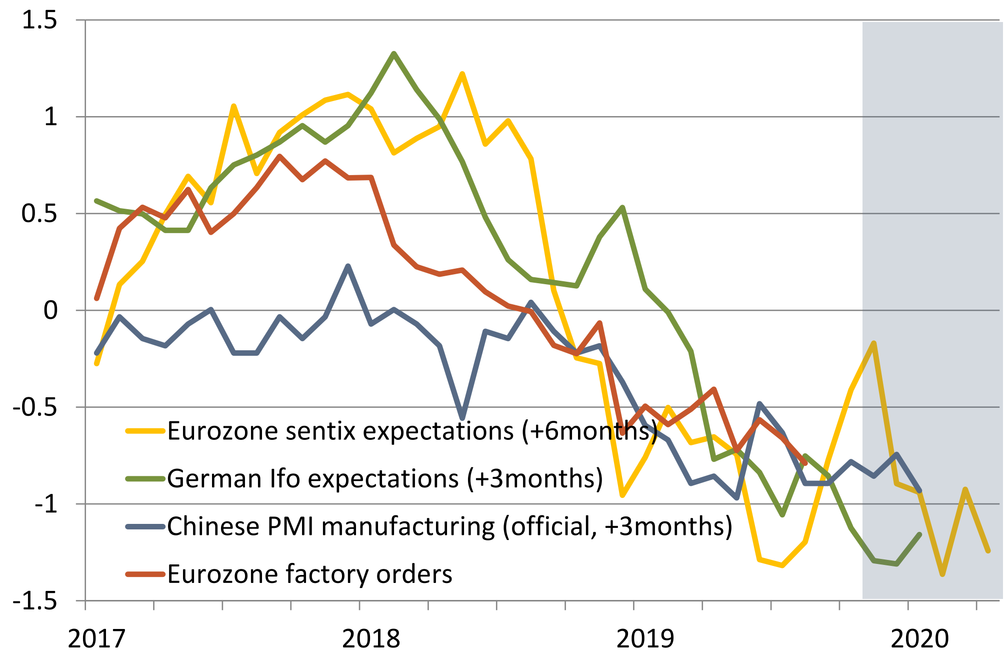
Things could turn slowly up 2020: Tentative progress on trade and Brexit has supported a turn to a less downbeat outlook in financial markets. But the progress does not yet suffice for a fast and sustainable return to healthier levels of economic confidence, production and trade. For Q4, we expect GDP growth slightly below the Q3 pace amid a challenging external environment (see Chart 1). If trade tensions recede further in coming months with a first US-Chinese deal, the UK decides on an orderly Brexit from the EU and the Chinese economy does not weaken too much, the upturn could gradually gather momentum throughout 2020. This is our base case.

Chart 1: GDP growth and its contributions to growth



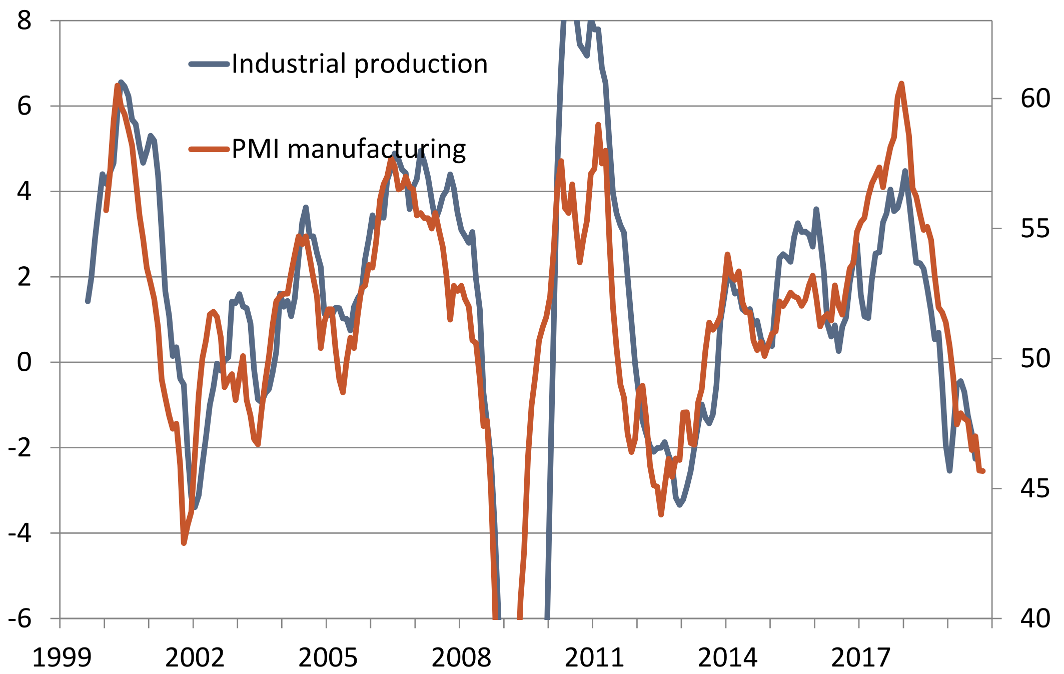
Qoq GDP growth in %, contributions in %-points. No breakdown for Q3 2019 and beyond. Berenberg projections from Q4 2019 onwards. Source: Eurostat, Berenberg

Chart 2: Leading indicators



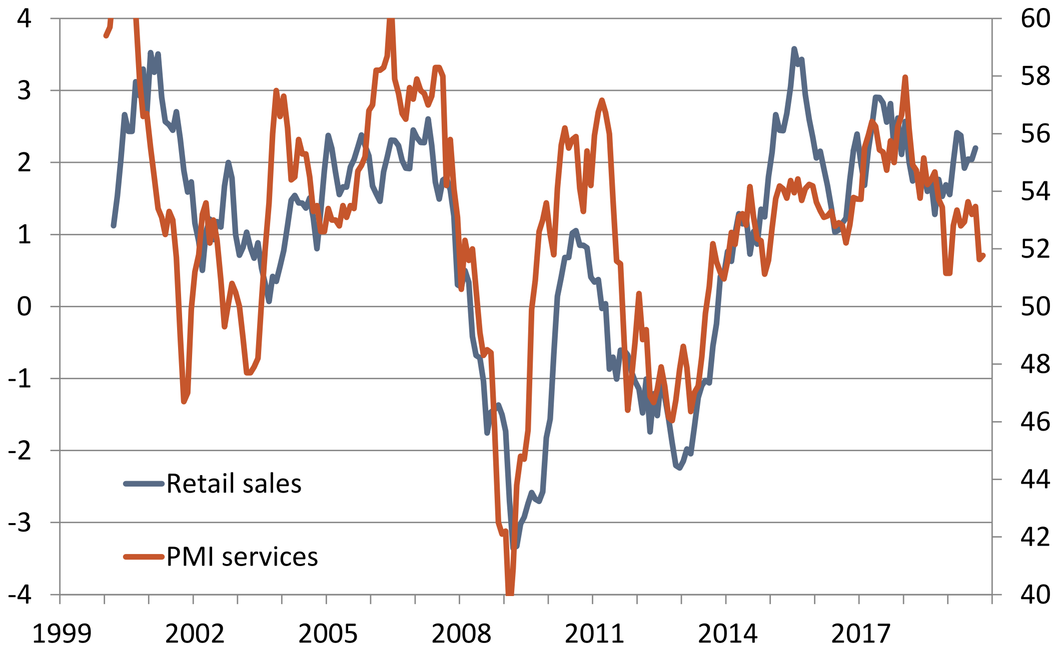
Factory orders (yoy growth in %) and key indicators normalised by average and standard deviation since 2005. Source: Sentix, Ifo, Caixin, Eurostat, Berenberg

Chart 3: Weakness in goods-producing sector continues, but signs of bottoming out



Three-month average of yoy growth in industrial production, left scale, PMI manufacturing (50=no expansion), right scale. Source: Eurostat, Markit, Berenberg.

Chart 4: Services still fairly resilient, but not unscathed any longer



Three-month average of yoy growth in retail sales, left scale, PMI services (50=no expansion), right scale. Source: Eurostat, Markit, Berenberg.

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