Economics

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European update: a more protracted slowdown

- **External risks take their toll:** In response to ongoing trade tensions and the mounting Brexit turmoil, we lower our GDP forecasts for major parts of Europe. We postpone our call for an end of the industrial recession from Q4 2019 to Q1 2020. Until the end of 2019, overall economic growth will likely remain subdued in the Eurozone and the UK. Export-dependent Germany could be close to stagnation.
- **Forecast revision:** The revisions have a greater impact on our calls for annual GDP growth in 2020 than in 2019. The persistent weakness in late 2019 lowers the starting level for 2020. For the Eurozone, we now project 1.2% instead of 1.4% growth in 2020 after 1.1% in 2019. German growth is likely to recover merely to 1.0% instead of 1.3% next year after 0.6% this year. For the UK, we now look for a 1.2% instead of a 1.3% rise in GDP in 2019 and 1.8% instead of 1.9% growth in 2020. The impact on other countries we cover is small as they are less dependent on industry and/or less affected by Brexit risks (see Table 1).
- **Four key conditions for a rebound:** Since early 2018, political risks have often trumped economic fundamentals. At the start of 2019, we pointed to four key conditions that would need to be met for a return to trend growth in GDP: (i) central banks turn suitably dovish; (ii) trade tensions fade somewhat; (iii) China stimulates demand; and (iv) the UK avoids a hard Brexit.
- **Partial progress only:** The first condition has been easily met. The **Fed** is cutting rates, the **ECB** will follow shortly and the **BoE** has put rate hike plans on hold. Since late 2018, **China** has delivered a series of moderate monetary, credit and fiscal stimulus measures. The government looks ready to go further if need be. However, at 49.7 in July, China's manufacturing PMI continues to hover below the 50 neutral mark. The risks to our call for an upturn in Chinese import growth from -4.1% yoy in Q2 to +3.3% yoy in Q4 2019 and +4.5% in early 2020 are tilted to the downside.
- **A cocktail of risks:** The worst trade risk – a full-scale tit-for-tat trade war between the US and the EU – has not (yet) materialised. Although we consider it highly unlikely that the US would impose 25% tariffs on car imports from Europe and Japan, the threat continues to linger. Despite on-and-off negotiations between China and the US, the two sides have not managed to contain their trade dispute. With the rise of Boris Johnson to power in the UK, the risk of a hard Brexit has risen to 40%. And even if the UK parliament prevents a no-deal Brexit on 31 October, the immediate result could be a period of heightened uncertainty in the run-up to potential new elections and/or even a new Brexit referendum in the UK.
- **Uncertainty hurts:** Our base case remains that trade tensions will be contained eventually, that the UK will narrowly avoid a hard Brexit and that China's import growth will rebound. But the chances that the key trade and Brexit issues could all be resolved within the next three months have receded. As uncertainty looks set to weigh heavily on confidence, exports and investment for longer, the Eurozone may not return to trend growth before Q2 2020. The cocktail of risks strengthens the case for a further easing of ECB policies on 12 September. We do not expect a major fiscal response beyond the modest fiscal stimulus that is in the pipeline already.

Table 1: What has changed? Berenberg forecasts for real GDP growth

	2018	2019			2020			2021
		New	Old	Change	New	Old	Change	
Eurozone	1.9	1.1	1.1	0.0	1.2	1.4	-0.2	1.6
Germany	1.5	0.6	0.6	0.0	1.0	1.3	-0.3	1.5
France	1.7	1.2	1.2	0.0	1.5	1.5	0.0	1.7
Italy	0.7	0.1	0.1	0.0	0.8	0.8	0.0	1.1
Spain	2.6	2.3	2.3	0.0	2.0	2.0	0.0	1.9
Portugal	2.1	1.7	1.7	0.0	1.8	1.8	0.0	1.7
UK	1.4	1.2	1.3	-0.1	1.8	1.9	-0.1	1.7

Yoy changes in %; new forecasts versus those published in Berenberg's Forecasts at a Glance on 26 July 2019.
Source: Berenberg

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Eurozone outlook

Since mid-2018, global trade and industry have been hit by a series of shocks ranging from trade wars stoked by US President Donald Trump to a major slowdown in China and a rising risk of a hard Brexit. Unsurprisingly, this has affected Germany – with its strong reliance on the export of highly cyclical goods such as cars, machine tools and base chemicals – more than almost all other countries in the Eurozone. While industrial sentiment has plunged in Germany, it has receded much more modestly elsewhere in the Eurozone (see Chart 1). In a similar vein, strong gains in real incomes and employment have largely shielded the services sector in Germany and the Eurozone from the carnage in parts of industry (see Chart 2).

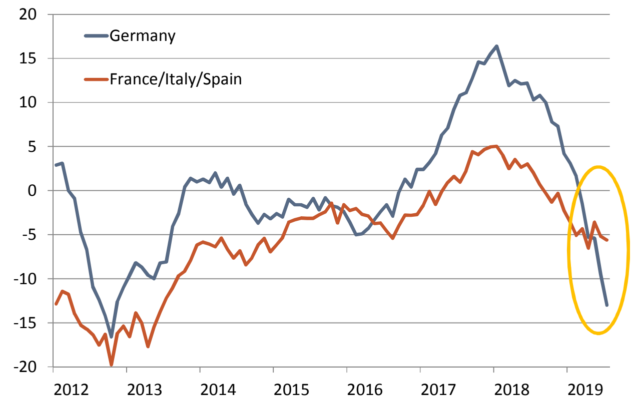
The impact of these external shocks shows up in the GDP data for Q2. In the Eurozone as a whole, growth slowed from 0.45% qoq in Q1 to 0.2% qoq in Q2. Whereas France (0.24% qoq in Q2 after 0.3% qoq in Q1) and Spain (0.5% after 0.7% in Q1) exceeded the average and Italy stagnated after a mild contraction of -0.1% qoq in Q1, the difference between the weighted average of the countries for which data are already available and the flash estimate for the Eurozone as a whole suggests that the German economy expanded by around 0.1% qoq in Q2. If so, that would be above our -0.1% qoq forecast. A 3.5% mom surge in retail sales in June may have given Germany a late boost after very weak data for April and May.

As usual, we need to take quarterly data with a pinch of salt. The Q1 result had been boosted by a number of special factors such as an unusually mild winter and a late Easter that shifted factory holidays from Q1 (March) fully into Q2 (April). Slower growth in Q2 is partly a payback for the Q1 boost. Abstracting from such special factors, the Eurozone economy expanded at an average pace of just over 0.3% qoq in H1 2019, modestly below its trend pace of 0.4% qoq.

For the second half of the year, we now expect Eurozone growth to come in below the H1 average. External risks have not receded yet. Surveys such as the purchasing managers' indices, the German Ifo or the European Commission's sentiment indicator for the Eurozone continue to signal an ongoing serious downturn in industry. In addition, the slight uptick in German unemployment since May and the gradual erosion of overall economic sentiment in the Eurozone outside Germany suggest that the industrial recession is slowly reducing growth momentum in other parts of the economy as well. Beyond those services that directly support industry, consumer spending may also be affected modestly over time. While consumer confidence remains elevated at -6.6 in July versus -4.9 in 2018 and a long-term average of -10.7, consumers have started to worry more about the labour market than before. The subindicator for consumer concerns about unemployment in the next 12 months worsened to 9.6 in July after an average of 4.0 in 2018.

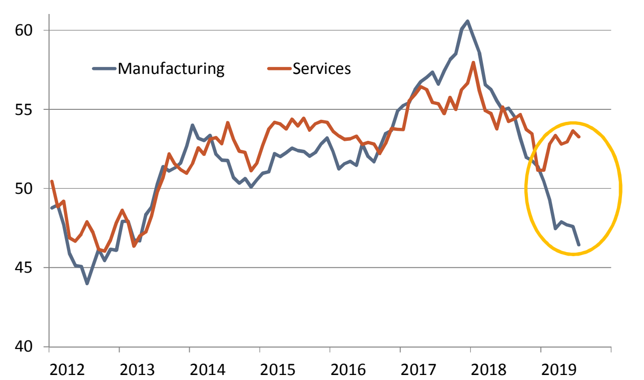
For the Eurozone, we maintain our call for subdued growth of just 0.2% qoq in Q3. More importantly, we lower our forecasts for qoq growth from 0.3% to 0.2% qoq for Q4 and from 0.4% to 0.3% qoq for Q1 2020. We continue to look for growth in line with the underlying trend of 0.4% qoq thereafter. These revisions reduce our projection for average annual growth in 2020 from 1.4% to 1.2% (see Table 2 for details).

Chart 1: Industrial confidence: largely a Germany story



Industrial confidence. Germany and GDP-weighted average of France, Italy and Spain. Source: European Commission, Berenberg calculations

Chart 2: Eurozone PMIs: manufacturing versus services



50=no change. Source: Markit

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German stagnation?

Among the key Eurozone member states, our forecast revisions affect mostly Germany. Amid the prolonged uncertainty about trade war and Brexit risks, companies across much of the globe do not know how they should revamp their cross-border supply chains. As they put investment plans on hold, they buy fewer machine tools from Germany, a prime supplier of these and other investment goods. We reduce our calls for German GDP growth in Q3 and Q4 2019 from 0.2% and 0.3% respectively to 0.1% for both quarters. Expecting uncertainty to recede only gradually, we also lower our call for Q1 2020 from 0.4% to 0.3% qoq. These revisions take our projection for Germany's annual average GDP growth from 1.3% to 1.0% for 2020. Our call for 2019 remains 0.6% as the upward revision to our Q2 estimate from -0.1% to +0.1% qoq offsets the downward revisions to growth in late 2019 (see Table 3 for details).

Taking Germany's growth of 0.4% qoq in Q1 and the small expansion of an estimated 0.1% qoq in Q2 together, the German economy apparently expanded by 0.25% qoq in the first half of this year. The second half of the year will likely be weaker. With just 0.1% qoq growth per quarter, we expect Germany to be close to stagnation. The risk that some special factor could cause a technical recession in the sense of two consecutive quarterly falls in GDP remains low. But it is not zero. A plunge in chemicals output comparable to the 10% fall of last autumn, if shipping on the Rhine were again halted by low water levels, could be such a factor. However, such an – unlikely – technical recession would be a mere aberration. The underlying cyclical momentum of the German economy is not that weak. With record employment and a shortage of skilled labour in many services sectors, we do not expect a major fiscal response beyond the fiscal impulse of around 0.3% of GDP that is already in the pipeline for 2019.

Three key assumptions

For our 2020 forecasts, we continue to make the following three key assumptions.

1) Trade tensions will eventually fade with at least a partial deal between the US and China that prevents new rounds of tit-for-tat tariffs. For their own sake, both countries should have an interest in containing the damage from their current trade war. In the US, Trump may also want to present a "deal" with China and continuing solid economic growth as arguments in his upcoming re-election campaign.

2) The ongoing if more modest gains in Chinese domestic demand and China's monetary and fiscal stimulus will show up in some renewed growth in Chinese imports.

3) The UK will avoid a no-deal hard Brexit in the end, although the risk of such a negative outcome looms large (we put it at 40%).

These assumptions highlight the continuing risks to our forecasts for a rebound in European growth next year. A further major escalation of trade tensions – say a new big round of US-Chinese tit-for-tat or even a 25% US import tariff on cars from Europe and Japan – or a hard Brexit could deepen and prolong the period of subdued growth in Europe, possibly tipping the Eurozone into stagnation and Germany into a mild recession for a couple of quarters.

UK outlook

Political uncertainties have intensified of late, as the new UK Prime Minister Boris Johnson has stepped up the hard Brexit rhetoric. We see only a 30% chance of an orderly Brexit on 31 October. This implies a 70% probability that the Brexit-related uncertainties will extend into Q4 in the form of either a hard Brexit on 31 October 2019 or political changes with an uncertain outcome in the UK.

In turn, real GDP growth will likely remain below potential in the near term linked to persistent weakness in investment and consumer spending on big-ticket items. Continued soft global demand will weigh on export-oriented industries too. We therefore downgrade the outlook for H2 2019 to an average quarterly growth rate of 0.3%, from 0.4% previously, and no longer anticipate a sharp rebound in Q4 (current 0.3% qoq, previous 0.5%). This lowers our call for UK real GDP growth from 1.3% to 1.2% in 2019, and to 1.8% from 1.9% in 2020 despite the likelihood that part of the lost output growth this year could be made up next year. Our call for 2021 remains unchanged at 1.7% (see Table 4 for details).

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Table 2: Eurozone economic forecasts

		2018	2019	2020	2021	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
GDP	% y/y	**1.9**	**1.1**	**1.2**	**1.6**	1.2	1.1	1.1	1.1	0.9	1.1	1.3	1.5	1.6	1.6	1.5	1.5
	% q/q					0.4	0.2	0.2	0.2	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
	%q/q ann.					1.8	0.8	0.8	0.9	1.2	1.6	1.7	1.7	1.5	1.5	1.5	1.5
Private Consumption	% y/y	**1.3**	**1.4**	**1.4**	**1.6**	1.1	1.3	1.5	1.5	1.3	1.4	1.5	1.5	1.6	1.6	1.6	1.6
	% q/q					0.5	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Government Consumption	% y/y	**1.0**	**1.3**	**1.5**	**1.5**	1.2	1.2	1.5	1.2	1.5	1.4	1.5	1.5	1.5	1.5	1.5	1.5
	% q/q					0.1	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Investment	% y/y	**2.0**	**2.5**	**2.2**	**2.7**	3.7	2.5	2.5	1.4	1.8	2.0	2.3	2.6	2.7	2.7	2.7	2.7
	% q/q					0.1	0.5	0.4	0.4	0.5	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Final Domestic Demand [1]	% y/y	**1.3**	**1.5**	**1.5**	**1.8**	1.6	1.5	1.6	1.4	1.4	1.5	1.6	1.7	1.8	1.8	1.8	1.8
	% q/q					0.3	0.4	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Net Exports [1]	% y/y	**0.5**	**-0.1**	**-0.3**	**-0.2**	-0.1	-0.2	0.0	-0.2	-0.5	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.3
	% q/q					0.2	-0.2	-0.1	-0.1	-0.1	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Stockbuilding [1]	% y/y	**0.1**	**-0.3**	**0.0**	**0.0**	-0.3	-0.2	-0.5	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	% q/q					0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Account Balance	EUR bn	**337**	**316**	**298**	**274**	91	75	71	78	88	72	65	72	82	66	59	66
	% of GDP	**2.9**	**2.7**	**2.4**	**2.2**												
Industrial Production [2]	% y/y	**0.9**	**-0.2**	**0.7**	**1.4**	-0.3	-0.5	-0.6	0.4	-0.1	0.4	0.9	1.4	1.5	1.4	1.4	1.4
	% q/q					0.9	-0.2	-0.1	-0.2	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Unemployment Rate [2]	%	**8.2**	**7.6**	**7.2**	**6.7**	7.8	7.6	7.5	7.4	7.4	7.3	7.1	6.9	6.8	6.7	6.6	6.5
CPI [2]	% y/y	**1.8**	**1.2**	**1.5**	**1.7**	1.4	1.4	1.1	0.9	1.2	1.3	1.6	1.6	1.6	1.7	1.7	1.8
General Govt. Balance	% of GDP	**-0.5**	**-1.0**	**-0.9**	**-0.8**												
General Govt. Debt	% of GDP	**85.1**	**84.1**	**82.8**	**81.0**												
ECB main refinancing rate [3]	%	**0.00**	**0.00**	**0.00**	**0.25**	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25

[1] Contribution to GDP growth [2] Period averages [3] End of period
Source: Berenberg

Table 3: German economic forecasts

		2018	2019	2020	2021	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
GDP [1]	% y/y	**1.5**	**0.6**	**1.0**	**1.5**	0.7	0.3	0.7	0.7	0.6	0.9	1.2	1.5	1.6	1.6	1.5	1.5
	% q/q					0.4	0.1	0.1	0.1	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
	%q/q ann.					1.7	0.4	0.5	0.4	1.1	1.6	1.6	1.6	1.5	1.5	1.5	1.5
Private Consumption	% y/y	**1.1**	**1.8**	**1.5**	**1.7**	1.6	1.5	2.0	2.0	1.2	1.5	1.6	1.7	1.7	1.7	1.7	1.7
	% q/q					1.2	0.2	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Government Consumption	% y/y	**1.0**	**1.4**	**1.6**	**1.7**	1.5	1.2	1.8	0.9	1.6	1.6	1.6	1.7	1.7	1.7	1.7	1.7
	% q/q					-0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Investment	% y/y	**2.7**	**2.4**	**2.0**	**2.6**	3.1	2.5	2.3	1.9	1.2	1.9	2.3	2.6	2.7	2.6	2.5	2.4
	% q/q					1.1	0.0	0.3	0.4	0.5	0.7	0.7	0.7	0.6	0.6	0.6	0.6
Final Domestic Demand [2]	% y/y	**1.3**	**1.7**	**1.6**	**1.8**	1.8	1.6	1.9	1.7	1.2	1.5	1.7	1.8	1.9	1.8	1.8	1.8
	% q/q					0.8	0.2	0.3	0.3	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Net Exports [2]	% y/y	**-0.4**	**-0.6**	**-0.5**	**-0.3**	-1.0	-1.0	-0.1	-0.4	-0.7	-0.6	-0.5	-0.3	-0.3	-0.3	-0.3	-0.3
	% q/q					0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Stockbuilding [2]	% y/y	**0.5**	**-0.5**	**0.0**	**0.0**	-0.1	-0.3	-1.1	-0.6	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	% q/q					-0.6	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Account Balance	EUR bn	**250**	**241**	**229**	**217**	67	63	52	60	64	60	49	57	61	57	46	54
	% of GDP	**7.4**	**7.0**	**6.5**	**5.9**	7.8	7.3	5.9	6.8	7.3	6.8	5.4	6.3	6.8	6.3	4.9	5.8
Industrial Production [3]	% y/y	**1.0**	**-2.2**	**1.2**	**1.5**	-2.2	-3.9	-2.3	-0.6	-0.1	1.6	1.6	1.6	1.6	1.5	1.5	1.4
	% q/q					-0.1	-1.3	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Unemployment Rate [4]	%	**3.4**	**3.2**	**3.0**	**2.8**	3.2	3.1	3.2	3.2	3.1	3.1	3.0	2.9	2.9	2.8	2.7	2.7
CPI [5]	% y/y	**1.9**	**1.5**	**1.5**	**1.8**	1.6	1.7	1.3	1.3	1.5	1.3	1.6	1.7	1.7	1.8	1.8	1.9
General Govt. Balance	% of GDP	**1.7**	**1.1**	**0.8**	**0.4**												
General Govt. Debt	% of GDP	**60.9**	**58.5**	**56.3**	**54.1**												

[1] Calendar-adjusted [2] Contribution to GDP growth [3] Ex construction, s.a., period averages [4] ILO measure, period averages, s.a.

[5] EU-harmonised, period averages

Table 4: UK economic forecasts

		2018	2019	2020	2021	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
GDP	% y/y	**1.4**	**1.2**	**1.8**	**1.7**	1.8	1.3	0.9	0.9	1.1	1.8	2.0	2.2	1.9	1.6	1.6	1.6
	% q/q					0.5	-0.1	0.3	0.3	0.7	0.6	0.4	0.4	0.4	0.4	0.4	0.4
	%q/q ann.					2.0	-0.4	1.1	1.0	2.7	2.6	1.8	1.6	1.6	1.5	1.6	1.6
Private Consumption	% y/y	**1.7**	**1.6**	**2.0**	**1.8**	1.7	1.4	1.5	1.6	1.7	2.1	2.1	2.2	2.0	1.8	1.8	1.8
	% q/q					0.6	0.3	0.4	0.4	0.7	0.6	0.5	0.5	0.5	0.5	0.5	0.5
Government Consumption	% y/y	**0.4**	**1.8**	**0.3**	**0.4**	1.6	2.5	2.1	1.1	0.4	0.0	0.6	0.4	0.4	0.4	0.4	0.4
	% q/q					0.8	0.5	-0.5	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Investment	% y/y	**0.2**	**0.4**	**3.1**	**3.3**	0.9	-0.1	-0.5	1.3	1.1	3.6	4.1	3.6	3.4	3.2	3.2	3.2
	% q/q					1.2	-1.5	0.4	1.2	1.0	1.0	0.8	0.8	0.8	0.8	0.8	0.8
Final Domestic Demand [1]	% y/y	**1.2**	**1.4**	**1.9**	**1.8**	1.5	1.4	1.3	1.5	1.4	2.0	2.2	2.1	1.9	1.8	1.8	1.8
	% q/q					0.7	0.0	0.2	0.5	0.6	0.6	0.4	0.4	0.4	0.4	0.4	0.4
Net Exports [1]	% y/y	**-0.2**	**-2.9**	**-0.1**	**-0.3**	-3.4	-2.7	-2.7	-2.6	0.2	-0.1	-0.2	-0.3	-0.3	-0.3	-0.3	-0.2
	% q/q					-2.9	0.3	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Stockbuilding [1]	% y/y	**0.4**	**0.5**	**0.0**	**-0.1**	1.5	0.6	0.3	-0.3	-0.5	0.0	0.0	0.3	0.2	0.1	0.0	0.0
	% q/q					0.3	-0.4	0.0	-0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Current Account Balance	GBP bn	**-81.6**	**-110.3**	**-96.5**	**-82.1**	-30.0	-27.6	-26.7	-25.9	-25.5	-24.6	-23.7	-22.8	-21.9	-21.0	-20.1	-19.2
	% of GDP	**-3.9**	**-5.0**	**-4.3**	**-3.6**	-5.6	-5.1	-4.9	-4.7	-4.5	-4.4	-4.2	-4.0	-3.8	-3.7	-3.5	-3.3
Industrial Production [2]	% y/y	**0.8**	**0.0**	**1.7**	**1.5**	-0.7	-0.1	-0.2	1.1	1.5	1.9	1.7	1.6	1.5	1.5	1.4	1.4
	% q/q					0.1	0.0	0.6	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Unemployment Rate [2]	%	**4.1**	**3.8**	**3.6**	**3.5**	3.9	3.8	3.8	3.7	3.7	3.7	3.6	3.6	3.6	3.5	3.5	3.5
CPI [2]	% y/y	**2.5**	**2.0**	**2.1**	**2.1**	1.9	2.0	2.0	2.0	2.0	2.1	2.2	2.2	2.1	2.1	2.0	2.0
General Govt. Balance [3]	% of GDP	**-1.6**	**-1.6**	**-1.2**	**-1.0**												
General Govt Debt [3]	% of GDP	**87.3**	**86.2**	**85.2**	**84.4**												
BoE Bank Rate [4]		**0.75**	**0.75**	**1.25**	**1.50**	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.50

[1] Contribution to GDP growth [2] Period averages [3] Maastricht basis [4] End period

Source: Berenberg

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