Florian Hense, Economist | florian.hense@berenberg.com | +44 20 3207 7859

EUROZONE ECONOMY: WORST RECESSION IN ALMOST 90 YEARS

Berenberg Macro Flash

As bad as expected. Amid the Covid-19 pandemic and the lockdown measures to contain its spread, Eurozone economic activity collapsed in the second quarter by the most since the early 1930s. According to Eurostat's first estimate, Eurozone GDP shrunk by 12.1%, wiping out 15 years of growth. Together with the first quarter decline of 3.6% qoq, the combined 15.3% drop in GDP from the pre-crisis level in Q4 2019 trumps the peak-to-trough fall during the financial crisis of 5.7%, which happened over five quarters (from 2008 Q1 to 2009 Q2). Chart 1 shows the unprecedented size and speed of the Covid-19 recession relative to the financial crisis.

Surprises across countries: All major Eurozone economies reported their worst declines in GDP since official series began (1970 for Germany, 1949 for France, 1981 for Italy and 1970 for Spain).

- Among the big four, **Spain** was the outlier with an even worse-than-expected plunge by 18.5% qoq vs. estimates of around -16.5%. While Italy was the first major Eurozone economy hit by the Covid-19 pandemic, Spain was the most affected in terms of infections and deaths, in absolute numbers and per capita terms. Consequently, Spain imposed one of the Eurozone's harshest and longest lockdowns which – as the Q2 GDP numbers show – came at a considerable cost. In addition, among the major 4 economies, Spain is the most reliant on tourism and travel. The sector contributes 14% to GDP compared to 13% in Italy and 9% in both France and Germany. Finally, Spain launched a smaller fiscal stimulus than Germany and France. Government consumption thereby did not offset the drop in private sector activity in April and jumpstart the rebound from may as much as in the other two countries.
- **France** and in particular **Italy**, on the other hand surprised to the upside by recording less-bad-than-expected contractions. Especially relative to **Germany** – where activity fell by 10.1% instead of our call of -8.5% possibly amid households holding back major purchases in June before the VAT cut in July – Italy and France held up better than we and markets had expected. French GDP contracted by 13.8% (expected: 15.3%) while Italy reported a decline of 12.4% versus estimates of -15%. After imposing lockdown measures earlier than France and Spain in Q1, Italy probably benefitted somewhat from being able to ease them a little earlier during Q2. Still, it remains somewhat a puzzle that the country at the centre of the Covid-19 pandemic, market turmoil and EU common fiscal response deliberations did less badly in H1 than both Spain and France. Having said that, Italian GDP in Q2 was back to levels last seen in 1993. In France, which suffered from a particularly harsh lockdown in April, a probably sharper-than-elsewhere revival of household consumption from May onwards contained the damage of the second quarter overall.

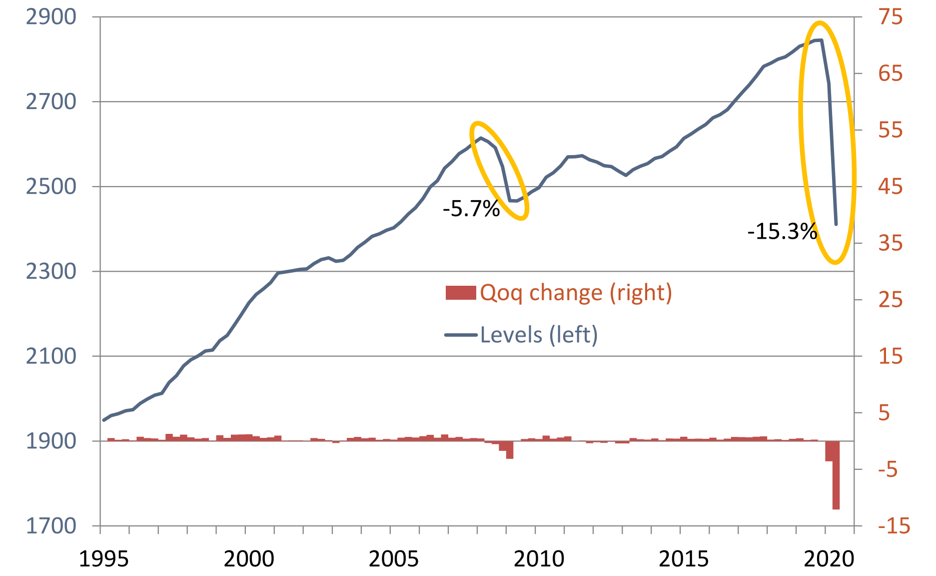
Q2 is a tale of two sub-periods: Eurostat does not provide an expenditure-based breakdown of the GDP data with its first estimate. Judging by the hard data published so far, the monthly surveys, high-frequency data and the already published national GDP estimates the second quarter is largely a tale of two sub-periods. In April activity was extremely depressed at levels 25-40% below normal due to draconian and widespread shutdowns and stay-at-home orders. From May onwards, activity rebounded sharply and gained more momentum during June as supply was being switched back on again. So far, however, mostly a significant recovery in retail sales has driven the recovery. On the back of pent-up consumer demand retail sales in Germany and France are only down by 0.3% and 6.2%, respectively, in Q2 relative to Q1. Non-retail service activities like restaurants and hospitality lag the retail sector. Industrial production has also rebounded, but remains well below pre-crisis levels. The average of April and May is 20% below the Q1 level for Eurozone industrial output. That could change gradually, though. As spending rises further and as overhanging stocks are used up, production growth should accelerate.

Weak investment and exports: Expenditure data from some countries such as France confirm that exports (-25.5% qoq in France) and investment (-17.8% qoq in France) slumped much more than private consumption (-11.0% qoq in France). Furlough schemes and other government handouts are limiting the impact of the record recession on consumer finances. While retail sales recovered fast when shops were re-opened, companies understandably prefer to hoard cash instead of spending it on investment for the time being.

Q3 outlook: Both the high-frequency data and the traditional monthly survey data suggest that activity picked up further during the first month of Q3. Yesterday's European Commission economic sentiment survey for July showed that production expectations among manufacturers turned positive. Both total and export order books rebounded for the first time since February. This bodes well. Helped by a base effect, Q3 should show a strong rebound in GDP relative to a Q2 depressed by a very weak April. With luck, the economy may recover close to half of its Q2 losses in Q3.

Medium-term prospects: It is unclear how quickly and significantly the pace of recovery levels off. Once most supply is switched back on again, the pace will depend largely on how demand recovers. Second wave fears could constrain household consumption and business investment. Spain, Italy and the south of Europe will suffer from a disappointing summer tourism season. Foreign demand will likely remain sluggish as other parts of the global economy take longer to bring the pandemic under control. At the same time, the fiscal/monetary policy stimulus in the pipeline is vast. Amid considerable uncertainty, we stick to our call for a tick-shaped recovery. We expect the Eurozone economy to reach its pre-crisis GDP level in mid-2022 again.

Chart 1: Eurozone GDP quarterly levels (in bn) and changes (qoq, in %)



Sources: Eurostat, Berenberg.

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7859
www.berenberg.com
florian.hense@berenberg.com