Holger Schmieding, Chief Economist | Holger.schmieding@berenberg.com | +44 20 3207 7889

EUROZONE CONFIDENCE: NO SPRING YET

Berenberg Macro Flash

Spring has not come to the Eurozone economy yet. Instead, economic sentiment fell modestly again in March for the third time in a row, from 103.9 in February to 103.0 now. This most encompassing survey of current economic conditions suggests that GDP growth remains below its 1.6% trend rate. We expect lessening concerns about China and oil as well as the tailwinds from modest fiscal easing and the additional ECB stimulus to lift growth back to its trend by mid-year. But this process has not started yet. As a small consolation for the ECB, selling-price expectations edged up slightly in industry and the services sector following the rebound in oil prices.

After significant declines in the two months before, **industrial confidence** stabilised in the Eurozone in March at -4.2 after -4.1 in February. The bad news came from the major domestically oriented **services** sector (down to 9.6 in March from 10.8 in February) and consumer confidence (from -8.8 to -9.7). As industry tends to be more cyclical and often moves ahead of the other sectors, the virtual stability in industrial confidence could be a signal that overall economic sentiment will also stabilise soon. This would be inline with the messages from the more forward looking surveys such as German ZEW investor expectations and German Ifo business expectations which had both moved up slightly in March after significant drops before.

At 103.0, the overall economic sentiment index came in below the Bloomberg consensus of a roughly stable reading of 103.8. That is bad news. But we have to put it into context. While sentiment has receded noticeably from its recent peak of 106.6 in December 2015, it remains above the long-term average of 100. As the chart below shows, the current setback is mild relative to previous downturns. It points to no more than a modest dent in overall GDP growth.

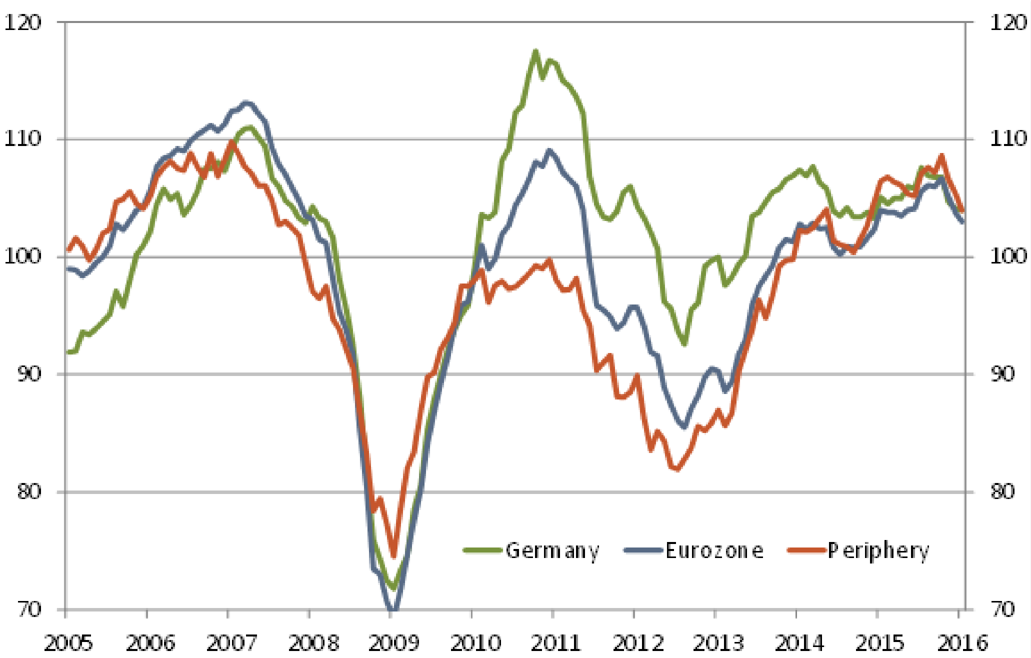
Looking at countries, the bad news came mostly from **France** (sentiment down from 103.7 to 101.9) and **Italy** (down sharply from 106.1 to 103.7). In France, sentiment weakened visibly in the industrial sector, contradicting the trend seen elsewhere in the Eurozone. But this seems to be largely a payback for the February result when industrial sentiment in France had unexpectedly strengthened against the overall trend in the Eurozone. Abstracting from this recent volatility, French industrial sentiment in March (-3.0) remained above its December 2015 level of -4.1. By and large, the data suggest that the French economy continues to muddle through at a growth rate well below trend. To gain additional momentum, France would need more pro-growth reforms. While the planned half-reform in the labour market would be a step in the right direction, it continues to fall short of what France would need to get unemployment down and economic growth up meaningfully.

In **Italy**, sentiment nosedived in the services sector (down from 9.0 in February to 3.2 in March) as Italian service providers saw a sharp downturn in demand. Whether this may be related to the unusual early Easter holiday or to a more permanent factor remains to be seen. Despite the March setback, overall Italian economic sentiment at 103.7 remains above the long-term average of 100 and above the Eurozone average of 103.0. Judging by these data, the Italian economy is currently failing to gain momentum. But it probably continues to expand at least at the very modest pace of 0.6% reached last year.

Spain may be showing the strains of political uncertainty. Following an exceptional peak of 111.9 at the time of the December election, economic sentiment has now fallen to 106.9 in March after 107.3 in February. While sentiment in Spanish industry and services turned up in March, consumers and construction companies became significantly less optimistic, with construction sentiment plunging from -22.7 in February to -42.5 in March. Spanish construction companies reported a major decline in their current activity (from 5.8 in February to -40.3 in March) and their order books (down from -31.2 to -50.5). As these numbers can be volatile, we should not read too much into them. But they seem to signal concerns that a protracted political stalemate will weigh on business and public construction projects. As chances look slim that the deadlock in Madrid will be resolved shortly, the uncertainty may prevail until potential repeat elections on 26 June.

The Greek malaise: once again, the data show a clear contrast at the south-eastern corner of the Eurozone. In **Cyprus**, a reform-minded government has turned the economy around successfully. Following the clean exit from its IMF-EU supports programme, economic sentiment has now surged further from 108.1 in February to 108.9 in March, the best result since the Lehman crisis started in September 2008. Having done what it had to do to get back on its feet, Cyprus can look forward to an almost V-shaped recovery. In **Greece**, however, the end to the misery inflicted by the Tsipras government is not yet in sight. Just before political uncertainty escalated in Greece in December 2014, Greek sentiment had risen to 102.8, even surpassing the Eurozone average. The Samaras government had finally put Greece on the right track. Unfortunately, Greece has not yet recovered from the political shock caused by the rise of Tsipras and Varoufakis to power in January 2015 and their subsequent policies of reform reversals and confrontations with creditors. Greek economic sentiment continues to languish at a level that is compatible with stagnation or even mild recession rather than the growth rates of 3% which it could have achieved if it had stayed on the reform path. In March 2016, Greek economic sentiment edged up slightly to 90.1, offsetting part of the decline from 91.6 in January to 89.0 in February. The earlier the Greek government now concludes the pending review of its bailout programme, the better. Otherwise, the looming threat of a new confrontation with creditors could prolong the Greek misery even further despite signs of a new record season in tourism.

Eurozone economic sentiment: a modest dip in early 2016



Economic sentiment, Eurozone, Germany and weighted average for Spain, Portugal, Greece and Cyprus; no data for Ireland. 100= long-term average. Source: European Commission

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7889
www.berenberg.com
holger.schmieding@berenberg.com