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EUROZONE Q2 GDP SLOWS, GERMANY SURPRISES, ITALY DISAPPOINTS

Berenberg Macro Flash

Quarterly GDP growth, Q2

	Eurozone	**Germany**	**France**	**Italy**	**Spain**
Actual:	**0.3%**	**0.4%**	**0.0%**	**0.0%**	**0.7%**
Previous:	0.6%	0.7%	0.7%	0.3%	0.8%
Consensus:	0.3% (flash)	0.2%	0.0% (flash)	0.2%	0.7% (flash)
Berenberg:	0.3%	0.3%	0.0%	0.2%	0.7%

Boosted by strong results from Germany, Spain and the Netherlands, the Eurozone economy continued to expand at a satisfactory pace in Q2. Although growth slowed from an unusually strong 0.6% qoq gain in Q1 to 0.3% qoq in Q2 as the unusually mild winter gave way to a more normal spring, the underlying trend remains encouraging. Although the likely descent of the UK into stagnation will probably retard Eurozone growth modestly in the next two quarters, resilient consumer demand will likely keep the upswing intact.

Germany

German expansion in the second quarter surprised on the upside with the qoq growth figure of 0.4% twice as high as expected (0.2%), benefiting from strong net exports, private and public consumption. For our take on Germany's Q2 GDP take a look at our earlier report of German upswing takes only a small breather. The outlook remains positive with Germany enjoying its "golden decade".

Spain

The Spanish GDP figure confirmed the preliminary flash reading of two weeks ago of a weaker, but still solid GDP growth of 0.7% compared to the first quarter (vs. 0.8% in Q1). While political gridlock has fuelled uncertainty among consumers and businesses since the elections in late June, the possibility of Rajoy finally on course to form a minority government thanks to the liberal Ciudadanos may prevent politics to weigh too much on the growth outlook. We see the outlook to be healthy with the economy expanding by 2.9% yoy this year, and 2.2% in 2017.

France

On the downside were Italy and France. The second reading of French GDP confirmed the qoq growth rate of 0.0% of the first reading, which was mainly due to a strong and upwards revised growth of 0.7% in Q1. We expect the French economy to expand by 1.2% this year and 1.1% next year. More and less timid structural reforms could lift the growth rate, but with France set to vote in spring next year these wishes fall on deaf ears.

Italy

Italian GDP surprised with stagnation of 0.0% vs. the first quarter. We and other economists expected Italy's Q2 GDP figure to show the sixth consecutive quarter of economic growth (0.2%), despite concerns that the recovery since the euro crisis could come to a halt later this year. With today's Q2 publication the Italian economy seems to have stalled earlier.

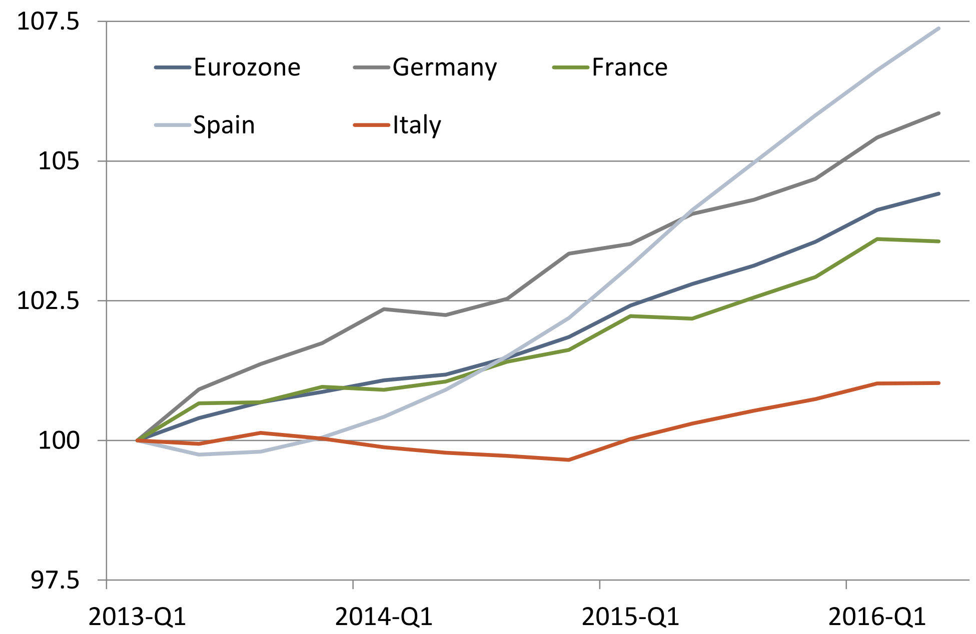
Italy has been suffering from economic problems for years. The economy has grown by a mere 1% since Q1 2013 which is by far the weakest among the four largest Eurozone economies (Germany: 5.9%, France:

3.6%, Spain: 7.4%) and way below the 4.4% for the Eurozone on aggregate (see chart). The large government debt load has weighed on government spending, the loss of competitiveness has affected business investment, especially by exporters which are struggling to benefit from the global economy's recovery after the financial crisis.

The persistent weakness of the economy has left the recovery throughout the last couple of years heavily dependent on personal consumption which is the only GDP component that has improved since Q1 2013. Consumer confidence held up in July, but as banking woes have intensified retail bond investors and savers may fear their financial situation to worsen, leaving confidence to drop. Policy-related uncertainties arising from the referendum on the constitutional reform (late November/early December) and the US elections (November) have also likely taken their toll on the personal consumption, and will increasingly do so, as these events approach. The political uncertainty about Renzi's fate following from the outcome of the referendum may be a reason for the setback in Q2 after improvements before.

Still, we believe Italy is yet to reap the full fruits of the labour reform Renzi introduced early 2015. The reform boosted business sentiment and growth since then. No or very timid recovery in the pre-Renzi period need not be a full predictor for the future. We are cautious towards the Italian outlook, with downside risks to our call of 0.8% GDP growth yoy for this year, and 0.9% in 2017.

GDP growth (2013Q1=100)



Source: Eurostat, Deutsche Bundesbank, Institut National de la Statistique/Economique, Instituto Nacional de Estadística, Istituto Nazionale di Statistica.

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