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

EUROZONE OUTPUT: SHRUGGING OFF BREXIT

Berenberg Macro Flash

No serious damage from the Brexit vote. After a revised 0.7% monthly drop in July, Eurozone industrial output rebounded strongly by 1.6% mom in August. Monthly data are too volatile to build any major story on them. The short-term volatility (weak July, strong August) probably reflects shifts in the pattern of factory holidays over the summer rather than underlying economic changes. But taken together, the data for the first two months of Q3 suggest that Brexit has not dealt a significant blow even to export-oriented manufacturing in the Eurozone.

In Q2, Eurozone GDP growth decelerated to 0.3% qoq and thus below its 0.4% qoq trend rate. An inventory correction reflecting the weaker export demand from emerging markets in the previous quarters had weighed on output in Q2. Following a 0.2% qoq drop in Eurozone industrial output in Q2, output for July and August taken together has now risen 0.1% above the Q2 level. That is not exactly a strong result. But it raises the hope that the inventory correction is over. Soft indicators such as the European Commission's industrial confidence index (up to -1.7 in September after -4.3 in August), the Eurozone manufacturing PMI (52.6 in September after 51.7 in August) and the forward-looking German Ifo business expectations for manufacturing (strong bounce to 7.8 in September after -3.0 in August) all point to more industrial momentum going forward. Today's output data flag some upside risk to our call for 0.24% qoq GDP growth in the Eurozone in Q3.

The good news for output in August is broad based. The German 3.1% monthly bounce in August may grab the headlines. But as it comes after a 1.9% drop in July, it seems to be strongly affected by shifting holiday patterns and other one-off effects in Germany. Encouragingly, output also advanced strongly in France (+2.0% in August after -0.5% in July) and Italy (+1.7% after +0.7% in July). Comparing the last two months to the Q2 average, Italy stands out with a 1.1% rise in output relative to Q2, far ahead of Germany (+0.05%) and France (-0.15%). Even Greek industry seems to be on the mend with a 0.7% gain in output for July and August versus the Q2 average. After stagnation in Q2, Italian GDP has likely returned to growth again in Q3 despite the mounting political risk. Whether that will help Prime Minister Renzi to win his 4 December referendum and thus avoid a potential political crisis is another matter. Most recent opinion polls project a small majority against his constitutional reform.

Going forward, we expect private consumption to contribute less to the gains in Eurozone aggregate demand. As the tailwind from cheap oil is blowing less forcefully, consumption growth could decelerate from 1.8% to around 1.4% yoy. At the same time, the headwinds from the emerging market crisis of late 2015 and the subsequent inventory correction should be fading. In the absence of major political or other external shocks, the Eurozone should expand at rates close to 1.5% yoy in the next few years, as it has done since mid-2014. If anything, today's industrial output data suggest that the short-term dent to growth which we had pencilled in for Q3 and Q4 after the 23 June Brexit vote could be even more shallow than we had projected.

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7878
www.berenberg.com
holger.schmieding@berenberg.com