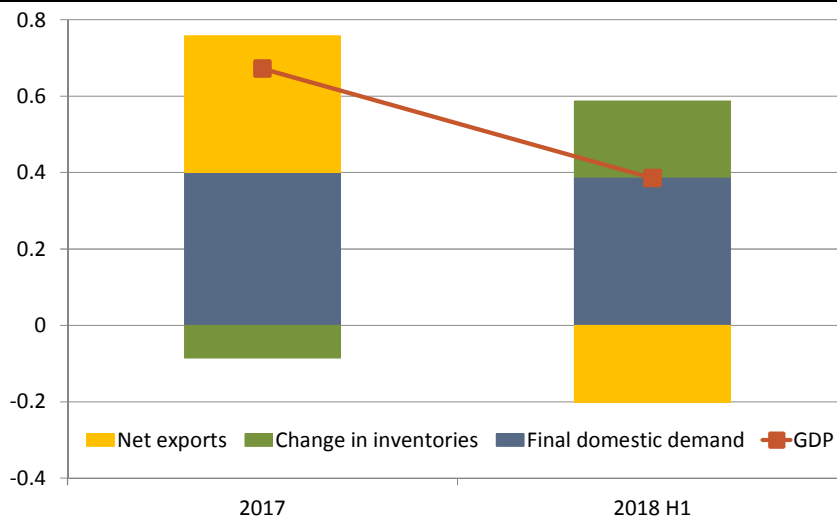


21 September 2018

Eurozone 2018: stable at home, big hit from abroad

Eurozone GDP growth and its contributions (qoq, in percentage points)



Contributions to quarter-on-quarter GDP growth in percentage points. Source: Eurostat.

- Back to trend:** After a stellar 2017 with average gains in GDP of 0.7% qoq, Eurozone growth moderated back to its trend rate of 0.4% qoq in H1 2018. Survey data project a similar pace of growth for Q3 and, possibly, for Q4 unless a potential easing of external tensions was to give confidence a boost in coming months.
- Blame trade:** So far, this year's slowdown in growth has been caused entirely by a more-challenging external environment. While net exports contributed almost half to GDP growth in 2017, they have been a drag on aggregate demand so far this year, shaving 0.2ppt from qoq growth. The 6.3% gain of the euro in trade-weighted terms throughout 2017, and an apparent slowdown in demand from China, contributed to more-subdued export growth. The increasing trade tensions further added to this from March onwards.
- Strength at home:** Importantly, the trade tensions stoked by US President Donald Trump have not fed through to the domestic economy – at least not yet. Today's published PMI surveys for September show that buoyant service providers have again withstood the drag from export-oriented manufacturers. Final domestic demand held up in H1 2018 with its contribution to qoq growth unchanged from 2017 at 0.4ppt. Thanks to continued gains in employment and stronger wage growth, consumers could weather the headwind from higher oil prices to their purchasing power. Despite some recent losses, consumer confidence in the first nine months of the year has exceeded the H2 2017 average. Capacity utilisation is still high and emerging labour shortages require businesses to invest more. Investment growth picked up in H1 2018 and offset a smaller contribution from public consumption, largely owing to a temporary weakness in Germany as the country had merely a caretaker government in Q1.
- The inventory buffer:** Changes in inventories have offset some of the huge swing in net exports. In 2017, companies partly met unexpectedly strong demand for exports by running down inventories. So far this year, they have used the slowdown in foreign demand to replenish their inventories. Of course, the recent contribution of inventories to aggregate demand carries a warning: if foreign demand eases further, companies may end up with excess inventories and scale back production further as a result.
- Rebound in late 2018 at risk?** The worst of the trade tensions between the US and the EU should be over, with the truce concluded on 25 July between Trump and Jean-Claude Juncker. The weak German industrial data in July should, therefore, be put into perspective. Some business surveys for August have pointed to a rebound in confidence. We expect Eurozone growth to rebound to a pace of roughly 0.5% qoq and thus above the 0.4% qoq trend. However, the escalating trade war between the US and China, the daily Italian budget noise, the culminating Brexit talks and the crisis in some emerging markets could continue to overshadow the Eurozone's solid domestic fundamentals for a while. The risk has risen that Eurozone growth may not yet regain further traction in Q4 2018.

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