Eurozone

A favourable cyclical environment

■ **The focus on political risk in Europe in recent months has tended to overshadow the economic upturn. Yet favourable statistics suggest that growth will maintain a cruising speed that might not be all that high, but at least is comfortable.**

■ **Eurozone GDP rose 0.5% q/q in Q1, and Q2 prospects are looking bright. Growth slowed somewhat in France, but it accelerated in Germany and surprised to the upside in Spain.**

Europe's horizon is clearing, and not only from a political perspective. The most recent economic statistics suggest that European growth this year could hold very close to last year's pace. In the first quarter, in any case, activity was relatively buoyant, up 0.5% compared to Q4 2016, according to Eurostat's preliminary statistics released in late April. Everything suggests that the second quarter has also gotten off to a strong start, and confidence surveys are looking very upbeat. The European Commission's business sentiment index rose strongly again in April, to the highest level in nearly 10 years (August 2007). The breakdown of opinions shows that business confidence is high and rising in all sectors (industry, services, retailing and construction). Household confidence is also upbeat, with a big improvement in unemployment expectations. Another key indicator, Markit's composite PMI index for the eurozone, rose to 56.8 in April, which is compatible with quarterly GDP growth of nearly 0.7% at the beginning of Q2. Although we do not necessarily expect such strong growth this spring, these results nonetheless indicate that the risks for our outlook are probably on the upside.

On a year-on-year basis, eurozone growth has been holding between 1.5% and 2% for the past two years (1.7% in Q1 2017). Although far from exceptional, this is nonetheless well above current estimates of the eurozone's long-term growth potential[1]. It is strong enough for an ongoing decline in the unemployment rate, which slipped to 9.5% in March and will apparently fall below 9% before the end of the year.

Among the good economic news, we would like to highlight the strength of retail sales (+2.3% y/y in volume in March 2017), which suggests that household consumption has held up fairly well in the face of rising inflation. The surge in inflation over the past six months (the harmonised index rose from 0.5% in October to 1.9% in April) is one of the main arguments for a slowdown in activity in 2017. Another positive factor is the vigour of domestic demand, which is spreading and consolidating within the eurozone, resulting in the acceleration of intra-zone trade.

The national breakdown of first-quarter performances will not be fully available for a few more days. We already know, however, that France will rank among the economies that slowed, with Q1 growth of 0.3% q/q, slightly weaker than in Q4 2016[2].

In Spain, in contrast, economic growth accelerated slightly to 0.8% q/q in Q1, and is generally holding at a very robust rate (+3% y/y). In Germany, too, activity accelerated, with GDP up by 0.6% q/q in Q1, after +0.2% and 0.4% in the previous quarters of 2016. According to qualitative comments from the Federal Statistical Office, it seems that both internal and external demand contributed positively to GDP growth. External trade accelerated. Fixed capital formation accelerated sharply in construction due to the mild weather but was also markedly up in machinery and equipment. Both public and private consumption expenditure increased slightly.

All of these factors helped convince the European Commission to raise slightly its spring growth outlook for the eurozone, to 1.7% in 2017 and 1.8% in 2018. The economic environment is expected to remain buoyant in the months ahead: world growth is bound to strengthen, and oil prices should continue to level off. The European Central Bank seems determined to maintain a very accommodating monetary policy for many long months ahead, even though the balance of risk is shifting little by little. Against this backdrop, member states must take advantage of this grace period and economic rally to continue making economic adjustments, cleaning up public finances when necessary and rebuilding their own manoeuvring room in terms of economic policy.

Composite PMI and growth

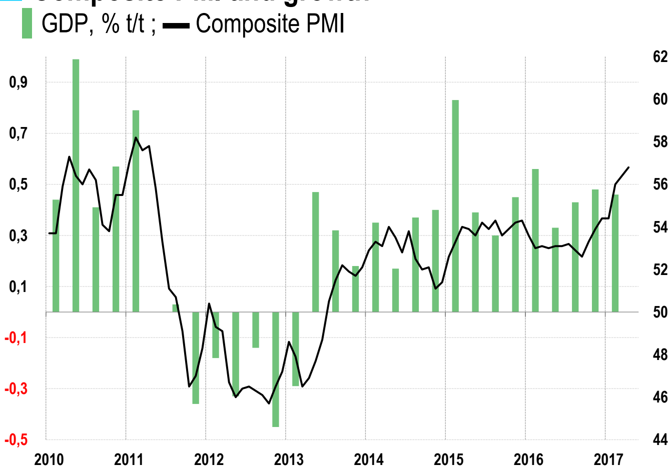

Chart Sources: Markit, Eurostat

[1] Estimated at 0.9% by the OECD, and 1.2% by the European Commission.

[2] See "Mild first-quarter growth" EcoFlash of 28 April 2017, BNP Paribas