ECONOMIC RESEARCH

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EUROZONE

Consumption leads the way

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Declining and, in some cases, negative inflation rates in the eurozone have fanned the discussion about deflationary risks. The concern is that, with the de-anchoring of hitherto stable inflation expectations, goods purchases could be postponed and investment restraint reinforced. But there are now growing signs that economic momentum in the eurozone is picking up, with growth in the final quarter of last year already slightly stronger. The number of people in work rose by almost a million compared with a year earlier. In January 2015 eurozone retail sales were up by an impressive 3.7% real on a year earlier, with Germany logging a sizzling 5.3% increase.

Europe is currently benefitting from several cyclical tailwinds. The main drivers are the falling euro exchange rate and cheaper commodity prices. The slide in the trade-weighted value of the euro by about 10% since the middle of last year should – if it persists – boost exports by an estimated 3 percentage points and have a positive impact of 0.4 – 0.5% on eurozone GDP. The fillip from the collapse in oil prices is of a similar magnitude, despite the recent stabilization in prices. A 10% drop in the oil price increases purchasing power by around 0.3%. This means that the 30% slide in the oil price since mid-2014 has lifted real incomes by almost 1%. Assuming the savings rate remains more or less flat, this results in an estimated GDP effect of 0.4%. Even if in the short term the purchasing power gains are not channeled fully into higher spending and the savings rate rises appreciably, given zero interest rates it is unlikely that the real income gains will flow permanently into savings. With its decision to purchase bonds to the tune of more than EUR 1000bn, the European Central Bank has pushed yields on top-grade government bonds further towards zero, curbing the incentive to save still more. Consumer spending is therefore highly unlikely to fall. Given what are already strong economic tailwinds, the ECB is acting in an extremely pro-cyclical manner.

Total private household labor income in the eurozone looks set to rise by 2.3% in 2015. In real terms the increase is actually likely to be close to 2.5%. The same is true for overall private household disposable income, with an increase of almost 2.5% on the cards. So there is plenty of scope for an expansion in consumer demand. In 2015 the eurozone will see an upswing in consumption.

As encouraging as this is, there are scant grounds for euphoria. We are looking at a cyclical tailwind which, typically of such trends, can be brought to an abrupt halt by external factors such as a renewed rise in commodity prices. It does little to fundamentally alter the growth outlook for the eurozone, which is characterized by extremely weak growth in production potential. A substantial step-up in investment is essential to improve the outlook on a lasting basis. But so far there are no signs of a sustained and substantial rise in the investment ratio.

With its bond-purchasing program the ECB is endeavoring to improve the lending environment. If commercial banks sell their government bonds to the central bank, they are likely to rediscover their taste for their traditional line of business, lending to businesses and financing investment – or so the argument goes. Firstly, however, given the regulatory backdrop it is doubtful whether the banks will significantly reduce the share of government paper on their books. Secondly, the cause of weak lending has less to do with constraints on lending but stems more from inadequate lending demand fueled by the uncertain economic outlook. Quantitative easing will therefore do little to stoke additional investment. The curbing of the propensity to save that it entails might boost consumption in the short term, but from a longer-term growth and demography angle it is highly detrimental.

Current monetary policy runs the risk of exacerbating economic ups and downs. As we saw in the financial crisis, such boom and bust cycles can wreak considerable economic harm. The aim should rather be to foster a stable and steady economic recovery, laying the foundation for a higher growth path in the medium term. With this in mind, monetary policy should revert to steady-hand mode as swiftly as possible.

Euro area: Economic indicators and forecasts*

		2014				2015				2016						
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2014e	2015f	2016f
GDP real		0.3	0.1	0.2	0.3	0.5	0.4	0.4	0.3	0.5	0.4	0.4	0.4	0.9	1.5	1.6
Private consumption		0.2	0.3	0.5	0.4	0.5	0.4	0.4	0.3	0.4	0.3	0.3	0.3	1.0	1.8	1.4
Government spending		0.1	0.3	0.3	0.1	0.3	0.3	0.2	0.3	0.2	0.2	0.3	0.3	0.9	1.1	1.0
Investment		0.3	-0.7	-0.3	0.3	0.7	0.8	0.6	0.6	0.8	0.8	0.5	0.6	0.7	1.7	2.8
Exports		0.4	1.4	1.3	0.9	1.2	1.0	0.9	0.8	1.2	1.0	1.1	1.0	3.7	4.3	4.2
Imports		0.4	1.3	1.4	1.1	1.1	1.2	0.9	0.9	1.3	1.1	1.0	1.0	3.7	4.6	4.4
Industrial production (excl. construction)		0.2	0.0	-0.4	0.3	0.5	0.7	0.5	0.6	0.6	0.5	0.4	0.4	0.7	1.5	2.2
Unemployment rate	%	11.8	11.6	11.5	11.4	11.3	11.2	11.0	10.8	10.7	10.5	10.4	10.3	11.6	11.1	10.5
Consumer prices	y-o-y	0.7	0.6	0.4	0.2	-0.5	-0.4	-0.1	0.6	1.1	1.3	1.2	1.2	0.4	-0.1	1.2
Producer prices	y-o-y	-1.6	-1.1	-1.4	-1.9	-2.2	-1.3	-0.5	0.9	2.0	2.1	2.0	1.9	-1.5	-0.8	2.0
Current account balance	EUR bn, sa	59.0	57.8	66.1	57.3	70.0	70.0	65.0	60.0	65.0	60.0	60.0	60.0	240.2	265.0	245.0
	% of GDP													2.4	2.6	2.3
Budget balance	% of GDP													-2.5	-2.0	-1.8

*) quarterly values: percentage change over previous period, seasonally adjusted, except where noted; annual GDP not adjusted; foreign trade incl.intra trade

f = forecast, e = estimate.

Germany: Economic indicators and forecasts*

		2014				2015				2016						
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2014	2015p	2016p
GDP real		0.8	-0.1	0.1	0.7	0.7	0.5	0.5	0.5	0.4	0.3	0.3	0.3	1.6	2.1	1.7
Private consumption		0.6	0.0	0.8	0.8	1.0	0.4	0.4	0.4	0.3	0.2	0.2	0.2	1.2	2.7	1.3
Government spending		0.1	0.6	0.6	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	1.1	1.4	1.2
Investment in machinery/equipment		2.0	0.6	-1.4	0.4	1.2	1.5	1.0	1.0	0.8	0.6	0.5	0.5	4.3	3.1	3.4
Construction		4.5	-3.7	-1.5	2.1	0.8	0.8	0.8	0.8	0.8	0.8	0.6	0.6	3.6	2.2	3.2
Domestic demand		0.9	-0.1	-0.4	0.5	0.7	0.4	0.4	0.3	0.4	0.3	0.2	0.2	1.3	1.7	1.4
Exports		-0.4	1.0	2.0	1.3	1.0	1.2	1.3	1.2	0.8	0.7	0.7	0.7	3.9	5.5	3.9
Imports		-0.2	1.2	1.3	1.0	1.2	1.2	1.2	1.0	0.9	0.6	0.6	0.6	3.4	5.1	3.6
Industrial production (excl. construction)**)		0.6	-0.6	-0.2	0.6	1.1	1.0	0.8	0.4	0.5	0.4	0.5	0.4	1.5	2.8	2.3
Unemployment rate (EU def.)	%	5.1	5.0	5.0	4.8	4.7	4.7	4.7	4.6	4.6	4.6	4.6	4.6	5.0	4.7	4.6
Unemployment rate (nat. def.)	%	6.8	6.7	6.7	6.6	6.5	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.7	6.4	6.4
Employed persons (national def.)	y-o-y	0.7	0.9	0.9	1.0	0.9	0.7	0.6	0.5	0.3	0.3	0.3	0.3	0.9	0.7	0.3
Consumer prices	y-o-y	1.2	1.1	0.8	0.5	-0.1	0.2	0.3	1.0	1.5	1.5	1.5	1.5	0.9	0.4	1.5
Consumer prices (HICP)	y-o-y	1.0	0.9	0.8	0.4	-0.3	0.1	0.2	0.9	1.5	1.5	1.5	1.5	0.8	0.2	1.5
Producer prices	y-o-y	-1.0	-0.9	-0.8	-1.2	-1.2	-0.4	0.3	1.1	1.9	1.9	1.9	1.9	-1.0	0.0	1.9
Current account balance	EUR bn	51.6	51.2	59.1	54.0	56.0	55.0	54.0	53.0	53.0	53.0	53.0	53.0	215.9	218.0	212.0
	% of GDP													7.4	7.3	6.8
Budget balance	EUR bn													18.0	20.1	16.7
(Maastricht-definition)	% of GDP													0.6	0.7	0.5

*) quarterly figures: percentage change over previous period, seasonally and working day adjusted, except where noted, yearly figures: percentage change, not working day adjusted; **) yearly average working day adjusted.

f = forecast.

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