ECONOMIC RESEARCH

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EUROZONE

Eurozone economy purring nicely

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GDP continues to grow slightly above potential, capacity utilization has been above-average for a fair while now, the improvement on the labor market continues, wages are edging up – all in all, there are sufficient grounds to place more confidence in the eurozone economy. The ECB should adapt its communication soonest.

The eurozone economy got off to a good start to the year: According to Eurostat's flash estimate the pace of growth came in at 0.5% in the first quarter – on a par with the fourth quarter of 2016, the figure for which was revised upwards by one-tenth. This paves the way for full-2017 GDP growth of at least 1.7% (our forecast remains unchanged).

This now looks set to be the third year running in which the eurozone records growth slightly above potential. Industrial capacity utilization has of late climbed further to 82.6% and has now been above its long-term average of 81% for 10 quarters. The labor market picture continues to improve steadily. Although there is no hint of acute wage pressure, there are signs of a modest pickup: in the final quarter of 2016 the year-on-year increase in compensation per employee reached 1.5% (for the first time since early 2014). A further modest upward trend is on the cards. However, "second-round effects" obviously take time. Inflation has been very low for an unusually long spell and hence also inflation expectations. It will be a gradual process until the current normalization of inflation/inflation expectations feeds through into wage negotiations.

Against this overall backdrop the ECB would in our opinion be well advised to cautiously adapt its communication, i.e. abandon its loosening bias with

regard to key rates and QE as soon as possible. There are no longer grounds to stick with the current monetary policy stance which served to tackle the crises and deflation. The adverse side effects are becoming increasingly worrying, especially as, given the pickup in inflation, low interest rates now mean even lower/more negative real interest rates. We believe there is every reason to place more confidence in the eurozone economy. The time for a gradual exit from QE has come.

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