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EUROZONE

Business confidence confirms moderate growth pickup

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Economic momentum at the start of the year remains strong, in line with our expectations. After slowing in 2016, trade momentum should be boosted by a lower EUR in 2017 (1.05 against the USD) and the global growth acceleration. On the demand side, private consumption growth will remain steady as oil prices are set to remain moderate while employment growth is picking up. Rising inflation supports companies' turnovers while higher profitability should continue to boost investment growth this year. In addition, the loose policy mix, with the ECB continuously supportive at least until mid-2018 and a neutral fiscal stance in 2017, provides an important safety net ahead of a busy political calendar.

The composite PMI for the manufacturing and services sectors in the eurozone came in at 56.0 points in February, a rise of 1.6 points from January. The manufacturing PMI remained broadly stable (55.5) but the manufacturing output index rose by +1.1 points to 57.2. The services PMI remained on the same positive trend (+1.9 points to 55.6). The reading suggests quarterly GDP growth of 0.5 – 0.6% q/q in Q1, an acceleration from the +0.4% in Q4 2016.

Overall, the survey results point to a steady generalized improvement in business confidence across countries in both manufacturing and services sectors. The lower EUR (1.05 against the USD) as well as higher regional and global demand are giving a boost to exports and new export orders suggest that this trend will prevail in the coming months. Employment continues to

recover, having registered its highest rise since mid-2007 in the February survey. Inflation should remain on the rise as suggested by the pickup in firms' expectations for output prices. However, we see limited scope for second round effects as core inflation should remain steady. Indeed, wage growth is expected to remain contained.

In Germany both the manufacturing and the services PMI improved, with the German composite index climbing to 56.1 points, the highest level since April 2014. We expect a slight pickup in GDP growth in Q1 2017: +0.6 q/q from +0.4% in Q4 2016. The manufacturing output index registered its highest increase since start of 2014 (+1.9 points to 59.4), and rose more than activity in the services sector (+1 point to 54.4). New orders and new export orders in the manufacturing sector surprised positively in both level (3-year high) and rate of increase (fastest since start of 2014) as the lower EUR is boosting competitiveness of German companies. Job creation continued to increase in both sectors but this adds cost pressures in the services sector given the rise in wages. Input prices remain on the rise in the manufacturing sector as well, with metal and oil prices both recovering. The good news, however, comes from the improving pricing power for companies as output prices reached an almost 6-year high in February. Overall, this should boost total inflation to +1.9% on average in 2017 from +0.5% in 2016.

The French purchasing managers' index for the manufacturing sector fell by -1.3 points but the manufacturing output component remained unchanged at 53.8. By contrast, the services sector registered the highest increase since mid-2011 (+2.1 points to 56.2). The good news came from the employment component which rose for the fourth consecutive month, notably in the services sector and to a lesser extent in the manufacturing sector. This should help bring the unemployment rate down to 9.6% by the end of 2017. The bad news came from the persistent low pricing power capacity for companies as shown by the continued fall in the selling prices, for more than four years now. However, INSEE's quarterly survey showed the opposite, since selling prices increased by +0.2% in Q4 (for the first time in two years) and should climb by +0.3% in Q1. It supports our turnovers forecast for 2017 (+1.4%, after +0.3% in 2016). Overall, we expect GDP to grow by +0.5% q/q in Q1 2017, marking a slight acceleration from the +0.4% in Q4.

These assessments are, as always, subject to the disclaimer provided below.

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