

## A lacklustre effort from the eurozone's Big Three

Any sports commentator would tell you that Germany, France and Italy need to up their game to get a decent end result. Not all is lost, and we can't rule out pleasant surprises



France's Emmanuel Macron and the German President, Frank-Walter Steinmeier, before the start of the Euros.

### The eurozone as a whole

Before we move to the Big Three, let's look at the eurozone as a whole, and we were pleasantly surprised by the eurozone's early spring recovery. But we're still waiting for a turn in the inventory cycle. And, as we rightly predicted in December, private consumption has still not taken off, despite strong wage growth. The eurozone economy's 'to-do' list is still long. There are strong investment needs and debt sustainability issues. And what about the capital markets union and the energy and security union?

Given the electoral landscape, not least within the EU itself but also in France and Germany, decision-making is more difficult. In September, the European Commission needs to rule on austerity plans by several eurozone countries, including France and Italy. If they're too soft, it undermines the rules' credibility. Too tough, and support for populist opposition parties could rise and debt sustainability could quickly come back on financial markets' radar screens.

## 1 Germany: Positive surprises despite a weak start to the second half

After a short revival of optimism, the German economy is again stuck in stagnation. Weak industrial orders, high inventory levels and precautionary savings are still weighing on the economy. On top of that, the increasing number of insolvencies and individual company announcements of upcoming job restructurings are still hanging like the Sword of Damocles over the labour market this year. Policy uncertainty, as well as the well-known structural weaknesses of the economy, also make any strong rebound for this year highly unlikely.

Still, despite a weak start to the second half of the year, don't rule out potential positive surprises. In fact, it only needs a small improvement in industrial order books to get industrial production growing again, admittedly from low levels. And the highest increase in real wages in more than a decade should eventually loosen even German consumers' traditionally very tight wallets.

## 2 France: Losing momentum as policy uncertainty remains

The French economy hasn't particularly disappointed, especially considering the 0.2% QoQ GDP growth in the first quarter. But we think we've lost some momentum in the second. Business confidence has deteriorated slightly in recent months in both the manufacturing and services sectors. Indeed, it seems that hopes of strong tourist demand linked to the Olympic Games, which start on 26 July, have not materialised. At the same time, unemployment is rising, signalling that economic momentum is currently insufficient.

A slowdown in growth cannot be ruled out in the coming quarters. The political uncertainty that has emerged from the general election is likely to provoke a wait-and-see attitude among consumers and businesses. Some emergency measures, such as freezing the prices of certain goods or raising the minimum wage, could temporarily boost consumption, but this could later be paid for by a more restrictive fiscal policy.

## 3 Italy: Conditions for recovery of private consumption still in place

Progress on the recovery plan-front continues, notably when considering infrastructure investments. There's no room for complacency, though, as it's going to be essential to keep up the pace of implementation if you're going to convince rating agencies of Italy's merit and markets to bet on debt sustainability. The second half of the year will likely benefit from a combination of temporarily low inflation, labour market resilience, decent wage growth, and, consequently, a further recovery in household purchasing power. When matched with a decent savings ratio, now at 9.5% and above pre-Covid levels, this should create room for a gradual recovery in private consumption, with a temporary twist towards durables spurred on by the [introduction of generous incentives](#) for replacement cars early in June. We reiterate our call for GDP growth of around 1% until year-end.

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