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Eurozone GDP: an historic decline explained

First quarter GDP has been adjusted slightly upward to -3.6%. An historic decline nonetheless caused, by and large, by domestic lockdowns

The small upward revision to eurozone GDP growth in 1Q does not make much of a difference to the story. The revision was mainly due to an upward revision in France, from -5.8% to -5.3% quarter-on-quarter, bringing it to the same level as Italy and more in line with the length and depth of the lockdown, which had actually been slightly milder than in Italy.

The final estimate of 1Q GDP for the eurozone gives a good look under the bonnet at where things went wrong. First off, as the French revision confirmed: it is all about the lockdown. The lockdown only covers about two to three weeks of the quarter but has caused the largest ever quarterly decline in output in the eurozone. The effect was the largest on household consumption, which fell by -4.7% QoQ. While this was closely followed by investment at -4.3%, it is much more unusual for consumption to drop this quickly. Investment is more volatile these days, experiencing a larger decline in the third quarter last year, for example. The decline in net exports was relatively mild, as sharp drops in exports were not significantly larger than the decline in imports.

By industry, the largest decline was seen in services, especially wholesale and retail trade, which also includes accommodation and food service activities. These were hit hard by the lockdowns, falling 6.8% QoQ, which can hardly be a surprise. The manufacturing and construction impact was also significant at -3.4 and -3.8% respectively, despite differences on a country basis on whether industry was able to continue to work. Real estate, government, finance, IT and agriculture saw modest declines thanks to easier work conditions under the lockdown.

Employment data lags output significantly. The decline for employment was just -0.2% with many industries still adding jobs on a quarterly basis. Interestingly enough, agriculture has seen the largest drop in employment despite recording the mildest contraction in the first quarter. Small declines in manufacturing and service sector jobs suggest that the worst is still to come as the eurozone job market has been boosted by short-time work schemes and generally rigid labour markets that respond relatively slowly to output shocks. This means that labour productivity has been hit significantly by the shock but during severe downturns this does not give a lot of relevant insight into the structural state of the economy, which labour productivity normally does. Safely ignore it until the recovery phase has started.

So, the lockdown recession is in full force and the question now is when it will go away. The second quarter will show even weaker GDP and jobs figures, but it is all about the recovery in consumption and investment as the lockdowns are gradually lifted. As savings rates have gone up, the question is whether consumers can and want to spend again over the summer months and whether businesses can and want to invest again. As job losses continue to come in and revenues remain subdued even after restrictions are lifted, this is no done deal. A V-shaped recovery is therefore not in the making, but a wide variety of scenarios are still in play. Next up: June confidence figures, which will give critical information about where we are currently in terms of economic recovery, as the gradual easing of lockdown measures continues.

Author

Bert Colijn
Senior Economist, Eurozone
bert.colijn@ing.com

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