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The eurozone recovery is stuck in first gear

Eurozone GDP growth is unlikely to accelerate in the coming quarters; indeed, quite the contrary. With inflation now in a downward trend, the ECB can continue its gradual easing process, though it might have to step up the pace in the first half of 2025

These are difficult times for France's Emmanuel Macron and Germany's Olaf Scholz

No Olympic medal for industry

After an OK-ish second quarter, where GDP growth came in at 0.3% quarter-on-quarter, data for the third is mixed at best. Judging by sentiment indicators, the Olympic Games had a small positive effect in France in August. This, together with a strong tourism season in Spain and Italy, lifted services sentiment in the whole of the eurozone.

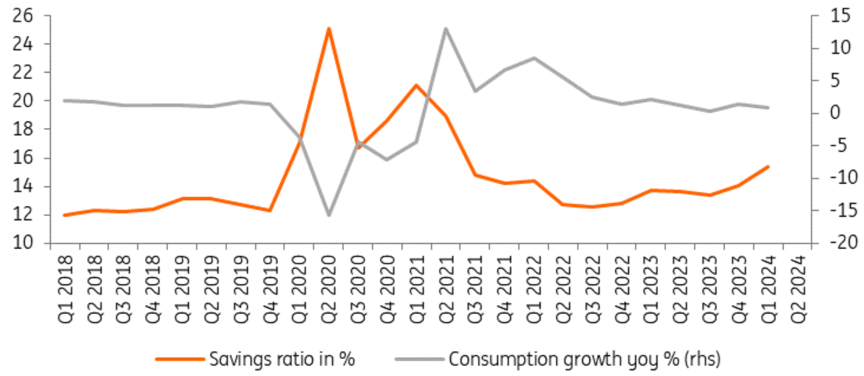
However, it would be premature to label this as the start of a growth pace acceleration. The manufacturing sector remains in the doldrums, with the inventory correction proceeding at a snail's pace, and the order books assessment remains at a depressed level. The German Ifo indicator declined for the third month in a row in August. The fact that even Volkswagen is now considering closing factories in Germany is testimony to the continuing industry rout.

Winter weakness seems likely

We are sceptical that the eurozone economy will accelerate in the second half. We're forecasting a deceleration in US growth, and domestic demand in China remains under pressure, so European exports are unlikely to be a strong growth driver. Low capacity utilisation in industry and weak credit demand are not heralding a strong pick-up in business investment either.

While households are now enjoying real wage growth, labour market expectations in the consumer survey have been softening since April. This might result in a higher savings ratio than an acceleration of consumption expenditure. All of this leads us to believe that the eurozone economy will continue to grow but at a slower pace. That doesn't take away the hopes for an acceleration from the second half of 2025 onwards. But on the back of weak winter quarters, it seems wise to downgrade next year's GDP growth to 0.9%, after 0.7% this year.

A rising savings rate is constraining consumption growth



Source: LSEG Datastream

Core inflation is coming down

HICP inflation fell to 2.2% in August, with core inflation declining to 2.8%. That said, services price inflation reaccelerated to 4.2%. This is likely to be a temporary effect, also due to the Olympics. Indeed, looking at the selling price expectations in the services sector, which has been a reliable leading indicator, services price inflation is likely to fall below 3.5% by the first quarter of next year.

While wage growth remains quite high, especially in Germany, the European Central Bank thinks this is temporary because of one-off payments. Wage growth is expected to fall back to 2.5% in the course of 2025. The bottom line is that inflationary pressures are softening, though headline inflation might still show some volatility over the coming quarters.

ECB stepping up easing pace in next year

On the one hand, the ECB seems to have gained confidence in its forecasts of gradual disinflation. But on the other, there is still the fear that easing monetary policy too rapidly might push inflation expectations up again. As Isabel Schnabel recently stated: "*Central banks must not abandon disinflationary policies too early*". So, we still expect the ECB to tread cautiously in the short run.

We maintain our forecasts of 25bp rate cuts both in September and December. On the back of the weaker growth outlook, we now believe that the ECB will step up the pace of easing thereafter, cutting rates by 50bp in both the first and the second quarters of 2025. Once the "neutral" level of 2.25% has been reached, the deposit rate is expected to remain at that level for quite some time.

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