

Eurozone's third-quarter growth surge could prove to be an illusion

Eurozone growth in the third quarter was unexpectedly strong, but this pace appears unsustainable. Winter is expected to be weak, which will likely lower the average growth for 2025. With falling inflation and a potential negative sentiment shock in the wake of Trump's victory, the ECB is likely to cut interest rates more rapidly



A new Limited Traffic Zone in Paris, and limited growth ahead for the eurozone, too

Growth surprises in the third quarter

The eurozone grew by a more-than-expected at 0.4% quarter-on-quarter in the third quarter. That was the strongest quarterly growth in two years. However, underlying growth dynamics are weaker than the headline figure suggests.

For starters, there is the extremely volatile Irish contribution caused by the accounting practices of multinationals based in Ireland, which added 0.1 percentage point to eurozone growth. And French GDP received a significant boost from the Olympics, something that will not be repeated in the fourth quarter.

The unexpected 0.2% growth in Germany was mainly driven by government expenditure and household consumption, as well as the downward revision of second-quarter growth. But

worsening job perspectives, highlighted by the announced closure of three German Volkswagen factories, and ongoing policy uncertainty, might dampen German household consumption growth in the coming quarters.

The winter months will be more challenging

The fourth quarter started with rather muted sentiment data. The PMI composite increased marginally but remained in contraction territory, while the European Commission's sentiment indicator fell in October. The inventory correction in manufacturing is still ongoing, with orders declining.

At the same time, the growth pace in services is softening. On the positive side, there is improving confidence in the retail sector, a sign that, for the time being, households are spending some of the increased real income.

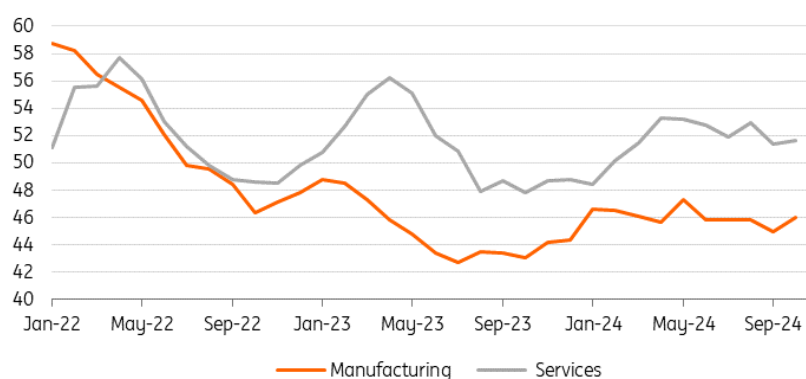
And though it might still take a few months before registering growth, confidence data in the construction sector has been creeping higher for four consecutive months. Nevertheless, we remain convinced that the winter quarter will see little growth, if at all.

Uncertainty stemming from a second Trump presidency regarding upcoming tariffs, deregulation in the US and American support for Ukraine might weigh on eurozone economic sentiment. A winter recession can no longer be excluded.

From the second quarter of 2025 onward, growth might start to pick up gradually. With a likely increase of US import tariffs, net exports are expected to be less of a growth driver in 2026.

On the back of the stronger-than-expected third-quarter growth in 2024, we have had to adjust our growth forecast for this year marginally to 0.7%. For 2025, we keep our 0.6% growth forecast, while we have downgraded our outlook for 2026 from 1.3% to 1.1%.

PMI sentiment figures remain weak



Source: LSEG Datastream

Inflation temporarily higher

After the better-than-expected September inflation, October data was a bit disappointing. Headline inflation rose to 2% year-on-year, while core inflation stabilised at 2.7% YoY. Month-on-month service price growth accelerated again.

Of course, we shouldn't read too much into one month's data. The trend still seems to be down, though on the back of less supportive base effects headline inflation is expected to increase further over the next two months.

Not that this will come as a surprise for the ECB, as President Christine Lagarde mentioned during the press conference at the last policy meeting that they expected inflation to rise in the short run.

Growth concern is likely to push the ECB to a 50bp rate cut in December

The ECB's rate cut in October came after the better-than-expected September inflation data and a very weak PMI reading.

The ECB's focus is now shifting towards sustaining growth. In that regard, it is no surprise that some members of the Governing Council have been pleading for a 50bp rate cut in December.

In normal times, the solid growth figure and eurozone unemployment falling to a record low in September would have discarded this proposal. But on the back of the Trump election, the fear of a negative confidence shock might be sufficient to tilt the balance towards a 50bp cut. Thereafter the ECB is likely to continue with a 25bp rate cut every meeting until the deposit rate reaches 1.75%.

Author

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.