

Eurozone: an economy flirting with stimulus

The marked slowdown in Eurozone GDP in the second quarter was broad-based. As the industrial slump deepens and downside risks for the months ahead increase, calls for stimulus will rise too.



The second estimate of GDP growth in the Eurozone confirmed the slowdown to 0.2% QoQ. Most countries saw a slowdown compared to Q1, which had been inflated by one-off factors. Germany clearly stood out with a contraction of -0.1%, but Italian output growth also stagnated in Q2. French and Spanish GDP growth slowed too, making the Netherlands the largest economy to maintain its Q1 pace of growth.

Eurozone industrial production provided more evidence that industry is currently the economy's Achilles heel. Production for the Eurozone as a whole plummeted by -1.6% in June. German industry declined by -1.8% in June, but was not the worst performer by a long shot. France saw production decline by -2.3%, while some of the smaller countries recorded even deeper contractions in production. July surveys have painted a worrying picture about production, causing concerns about continued weakness in the third quarter.

For how long can the labour market can keep Eurozone domestic demand afloat?

As the industrial recession in the Eurozone appears to be deepening, the pressure on the service sector intensifies. Surprising labour market strength has fueled domestic demand as industrial production has been contracting and second quarter employment growth did slow down to 0.2% from 0.4% in the fourth quarter. While continued job growth will still boost household consumption and maintain wage pressures, it does provide less fuel for domestic demand than before. As businesses indicate that hiring intentions are slowing, the question is for how long can the labour market can keep Eurozone domestic demand afloat?

Today's confirmation of a German contraction in the second quarter further ignites discussion about a possible broader downturn. With more downside risks down the line like Brexit, Italian political turmoil and trade war uncertainty, that debate seems to be legitimate. The ECB has all but decided on a next stimulus package for September, but the question is whether governments are willing to provide additional support if downside risks were to materialize.

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