Snap | 31 July 2018

Eurozone GDP growth weakens further, inflation higher to 2.1%

The Eurozone economy grew by just 0.3% QoQ in the second quarter with inflation increasing to above 2%. Any “behind the curve” thoughts that may have surfaced earlier this year can be parked

Supermarket shoppers in France

Whereas the decline in growth in Q1 was considered to be due to one-offs, it seems like excuses are running out to explain the even weaker Q2 reading. Perhaps still temporary, but factors with a longer shelf life seem to have brought Eurozone GDP growth down to a lower cruising speed for the moment. The confidence impact of a trade row and weaker real household income growth seem to be spoiling the European party for the moment.

Trade uncertainty seems to have already had a significant effect on the Eurozone economy in Q2. While the impact on real export growth has likely been small over the second quarter, the confidence factor has been more important. With lower confidence among businesses and consumers, concerns have likely translated into somewhat weaker domestic demand growth. In an economy in which capacity constraints abound and credit conditions remain favourable, confidence is the likely factor keeping investment down.

Lower consumer confidence has taken some of the wind out of the sails from consumption growth. This comes on the back of trade concerns, but also slowing growth in real household income per capita since mid-2017. The second quarter has added to this trend because the rapid pickup in fuel prices has likely outstripped wage growth. French data - the breakdown of GDP is already available in France - confirms that private consumption performed poorly as it declined by 0.1%.

Inflation remained high despite the weaker growth path that the Eurozone economy is on in 2018 but mainly driven by higher energy prices. The energy index increased by 9.4% YoY. These effects will weaken over the coming months, bringing the inflation rate more in line with core inflation. The core rate picked up to 1.1%, which is where it was in May as well. This is still weak and very much in line with ECB expectations. As the energy effects are temporary, the high inflation rate should be taken with a grain of salt from a policy perspective at the moment, so will the ECB.

The implications of the lower cruising speed of the Eurozone economy are quite clear. The weaker cyclical picture and low core inflation provide little reason for the ECB to increase rates before autumn next year. Any “behind the curve” thoughts that surfaced earlier this year when the mood was still Europhoric can be parked for the moment.

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