Eurozone goes through second technical recession as inflation jumps

Slightly better than expected, but a technical recession nonetheless in the eurozone as GDP fell again in 1Q. Underlying resilience shows that the economy is set for its (somewhat late) start to the pandemic rebound though, meaning that the picture of a lacklustre eurozone economy is set to change quickly

Restrictions have started to ease in the Netherlands which should help GDP numbers in the coming months

GDP falls again in 1Q due to extended lockdowns

The first quarter has been another disappointment in the eurozone as lockdowns were extended pretty much throughout the first three months of the year. With a decline of 0.6%, the eurozone has gone through its second technical recession during the pandemic.

Despite the decline, underlying developments were quite encouraging in the first quarter. Underlying activity started to pick up from mid-January onwards. Small easings of restrictions had quite strong effects on consumption, meaning that consumers seem eager to spend when reopenings happen. Also, unemployment has been declining over the course of the second wave, confirmed today by the March release showing a drop from 8.2 to 8.1%.

Besides that, the manufacturing sector has been roaring and is mostly held back by supply constraints at the moment. New orders are rising rapidly and businesses report strong current activity. That makes it a foregone conclusion that GDP will start to rise again in 2Q.

Inflation continues to rise as energy effect peaks

April headline inflation was pushed up from 1.3 to 1.6% on the back of another surge in energy costs on the back of base effects. The oil price reached a pandemic low in April last year after the Saudi-Russian dispute and extremely low demand due to worldwide lockdowns. This caused a large base effect pushing energy inflation up and will fade over the coming months when other upward pressures are set to take over.

Higher goods prices are also imminent as input shortages and supply chain pressures have caused import prices to jump recently. While businesses may absorb part of these higher costs in margins, it does seem logical that prices are set to rise further. We didn’t see a surge in April yet though as non-energy industrial goods' inflation increased from 0.3 to 0.5%. With services prices dropping, core inflation actually fell from 1.3 to 0.9%.

Concerns about medium-term inflation remain very mild though as all of the above factors are temporary. Collective bargaining agreements are currently disappointing in terms of wage increases and are set for multiple years. This reduces possible second-round effects from the 2021 jump.

A communication challenge for the ECB remains

The view on the eurozone economy is pretty poor at the moment in comparison to the US with another technical recession, vaccinations lagging, later reopenings and weaker fiscal support for 2021. Still, it looks like the fate of the eurozone economy is about to turn as domestic demand is set for a strong rebound when economies reopen and the manufacturing recovery seems to only be limited by its own supply at the moment. While late out of the starting blocks, the eurozone is set for its start to the pandemic rebound.

That means that the ECB will be challenged significantly in terms of communication over the coming meetings. With inflation approaching 2%, once GDP growth jumps on the back of reopenings it will become key for the ECB to get the message across that inflationary pressures look to be transitory for now.

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