

Stellar report card for Eurozone economy

What's not to like about strong growth, falling inflation and unemployment? But we think the drop in core inflation will certainly be taken as a justification for ECB's dovish tapering



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An impressive report card for the Eurozone economy as GDP growth comes in at 0.6% QoQ for the third quarter and the unemployment rate drops to 8.9%. The drop in core inflation to 0.9% will no doubt be taken as a justification for dovish tapering by the ECB.

The decline in core inflation was the most surprising data point today

GDP was slightly slower than the upwardly revised Q2. These revisions have contributed to a further improvement in the annual growth rate for 2017, which we now expect to come in at 2.3%. The current pace of economic growth is well above trend and is causing the output gap to be closed quicker than expected. While the expenditure breakdown has not been released yet, domestic demand has most likely been an important contributor to growth again, given labour

market strength and improving investment conditions such as higher capacity utilisation and improved lending demand and conditions.

In France, consumption growth increased, and investment growth remained robust at 0.8% QoQ.

The tick down in headline inflation was widely expected as energy base effects are pushing the inflation rate down for the moment. The drop in core inflation is more notable. The decline in core inflation may have been the most surprising data point today. It was well below analyst estimates and the lowest reading in five months. While seasonal effects are likely impacting the number to a certain degree, price growth in services dropped from 1.5% to 1.2% and these prices are likely to bounce back - this will be taken as a sign that last week's dovish tapering from the ECB was justified. Even though pipeline inflation pressures are slowly mounting, the 2% target is getting further away for now.

Will labour market recovery start to impact price growth? For now, don't hold your breath

Some positive news for inflation growth in the medium term is that unemployment fell significantly, to 8.9% in September. July and August were also revised downwards from 9.1 to 9%, causing the summer stagnation in unemployment to disappear. That stagnation would have been somewhat odd given the strength in economic performance and business survey data on hiring anyway.

This means the labour market recovery continues to underpin the economic recovery at the moment, which will boost GDP growth over the winter months. The most important question remains when the labour market recovery will start to impact price growth. For now, don't hold your breath.

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