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GDP growth holds in Q1, but only just

Eurozone GDP flash

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Contents

Summary

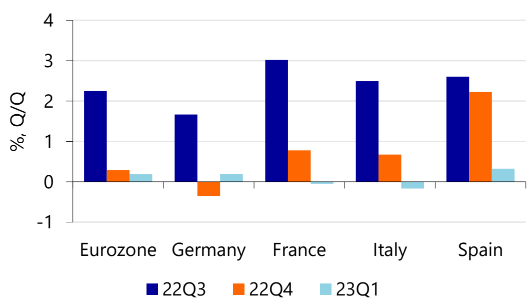
- In the first quarter of 2022 the eurozone economy grew by 0.2% q/q. The German, French, Italian and Spanish economy expanded by 0.2%, 0.0%, -0.2% and 0.3% respectively
- Eurozone inflation is persistently high, despite government intervention, and is increasingly more broad-based; today's (somewhat disappointing) GDP growth figures may actually be a sign that inflation is already weighing more strongly on demand
- Surveys paint a mixed picture for the near future, with consumer confidence down but PMIs still above the neutral mark
- We expect growth to remain positive in the second quarter, but to slow down significantly or even head for negative territory gradually, further out

Calm before the storm?

Eurozone Flash GDP figures out today underscored the fragile balance between the positive impact on output of 'reopening' of services sectors and manufacturing backlogs versus the deteriorating expectations and the increasing weight of inflation on real spending power. Overall, Eurozone GDP growth slowed to a mere 0.2% q/q. If it weren't for Germany (+0.2% q/q) and some smaller member states such as Spain, the Eurozone economy would actually have contracted, as French GDP stagnated and Italy's shrank -0.2% q/q. Against the backdrop of the weaker-than-expected Q1 GDP figures in the US (where the economy actually contracted due to 'special factors' such as a decline in inventories and sharply rising imports), this may still give the impression that the slowdown is already quite 'real' and perhaps even quicker than some would have hoped.

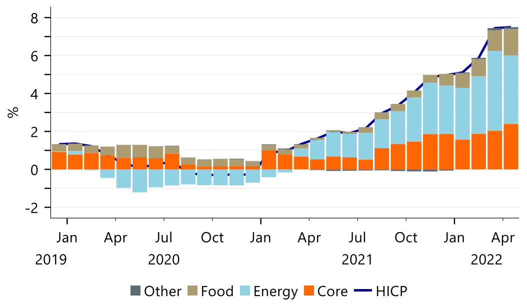
Although the GDP growth figure for the Eurozone still held above the zero-mark, the inflation figures published this week paint an even more worrying picture. Most governments have taken action to mitigate some of the inflationary pressure from higher gasoline prices, but inflation figures didn't go down as much as expected.

Figure 1: GDP figures for Eurozone countries



Source: Eurostat

Figure 2: Core inflation is accelerating



Source: Macrobond, Eurostat

Food price inflation, (the sort of inflation that no one can avoid and is especially painful for lower income households that spend a significant part of their income on food) was also up significantly at 6.4%. This development was to be expected, as businesses in the food sector have only relatively recently begun to raise their prices and so this rise in food prices has likely further to run. This is also something that will weigh on real spending going forward.

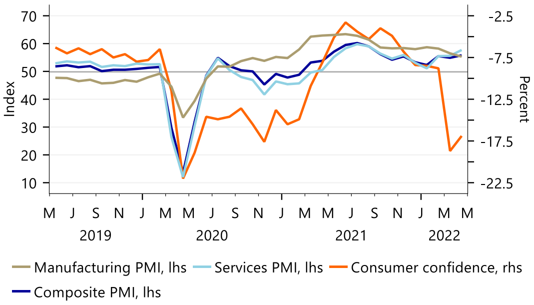
Of a bigger concern for monetary policy makers, though, is the ongoing upside surprises in core inflation. In a number of member states core inflation for April came in higher than expected again. It is now firmly above the ECB's target inflation. Some part of rise in core inflation is probably reflecting the (indirect impact) of rising food/energy costs on the back of higher commodity prices; think of restaurant prices. This usually goes unnoticed when energy and food prices rise only moderately. However, that is still only part of the story. For, supply-chain disruptions are also increasingly being felt at the consumer level. As such, the evidence is stacking up that inflation hasn't peaked yet and/or that the peak could be even more stretched than initially assumed (Figure 2).

Have surveys disconnected from economic reality?

In March consumer confidence plummeted to a low last seen during the early months of the pandemic. Meanwhile, other sentiment indicators, such as the purchase managers index (PMI) are at a 7-month high (Figure 3). So are there reasons to believe that one (or both!) of these indicators are disconnected from economic reality? What do these figures mean for short term economic growth?

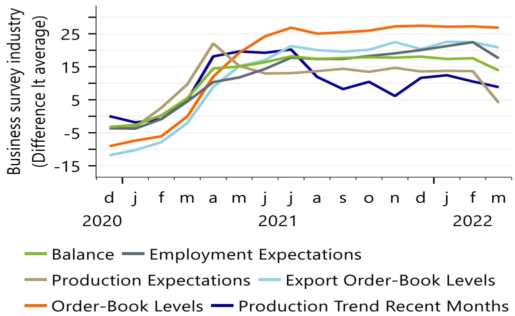
For both indicators we can make a couple remarks. First, the PMIs may paint an overly optimistic picture. Although the manufacturing and construction PMI are still above the neutral mark, the trend is definitely a negative one, with the manufacturing PMI currently at a 15-month low and the construction PMI at a 4-month low. Additionally, supplier delivery times lengthened significantly since the outbreak of the war in the Ukraine and the COVID induced lockdowns in China. Whilst this indicator may signal high demand in normal times, it currently points at disrupted supply chains. Moreover, the expectations for future output in industry are already quite downbeat. In construction the sub-indicator entered contractionary territory in March for the first time since December 2020 and in manufacturing it is much more pessimistic than over the past two years (Figure 4). The service sector in contrast, is still experiencing a boom on the back of the reopening of the economy and the abolishment of the last remaining covid measures.

Figure 3: Have consumer confidence and PMI's disconnected in the Eurozone?



Source: Macrobond, S&P global, Eurostat

Figure 4: Industry sentiment is deteriorating



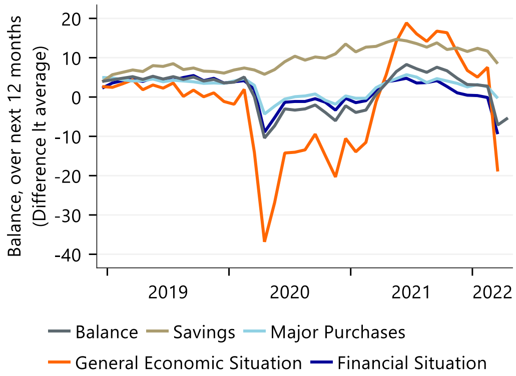
Source: Macrobond, Eurostat

Consumer confidence on the other hand might be a bit too overly pessimistic. The constant flow of negative news regarding the war and the sky high inflation is weighing on the overall mood. The high inflation rate could be somewhat misleading however. Energy prices still account for a large part of the current European inflation, but the methodology only takes new energy contracts into account. For consumers that have fixed rate contracts, most of the inflation pain is spared (for now). So from this perspective, and noting that consumer confidence is currently inversely related to inflation and noting the fact the labour market is still quite strong, consumer confidence may be giving too extreme a signal at the moment. In other words, the near-term outlook may not be as bad as signalled by the overall confidence index.

That said, we do see that inflation is starting to become more broad-based and that core inflation is starting to rise strongly however, as is evident from the 4.4% core inflation in Spain and 4.0% core inflation in Belgium. So going forward, consumers may still prove to be right in their pessimism towards dwindling purchasing power, especially since there is still plenty of room for consumer prices to catch up with producer prices (figure 6).

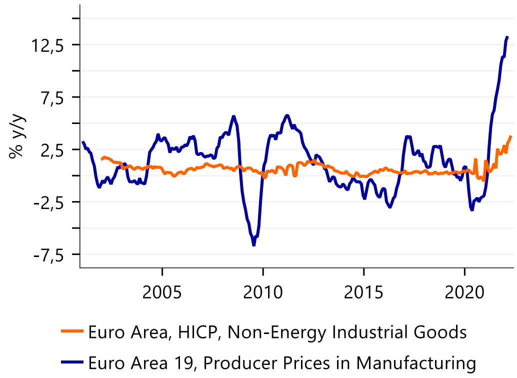
The consumer confidence index is made up of different subindices, such as consumers' expectations for their financial situation and their expectations towards doing major purchases (Figure 5). Especially the expectations about the financial situation and the expectations regarding doing major purchases have a lot of predictive value, albeit with a certain lag. These indicators are flashing red as well, although they are not as negative as the overall consumer confidence.

Figure 5: General economic situation is not the best predictor, but it is most negative.



Source: Macrobond, Eurostat

Figure 6: Consumer prices have yet to catch up with producer prices



Source: Macrobond, Eurostat

Grinding lower, but not yet heading for outright contraction

For now we expect the overall economic expansion in the second quarter to hold above the zero growth demarcation line. The economy is still benefiting from the removal of containment measures, pent-up demand for goods and full order books. However, today's GDP numbers also lend support to our view that high inflation will be a (slow) killer of economic growth.

If history is any guide, the sentiment indicators point towards slower or even negative growth in the coming quarters. The slowdown in economic will probably be gradual, as inflation slowly becomes more broad-based, but could still accelerate dependent on geopolitical events (such as a halt in Russian energy imports).

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