RESEARCH

EUROZONE ECONOMY

AUGUST 2018

The Eurozone's preliminary data has revealed economic growth of 0.4% in Q2 2018, matching the first quarter of the year, and an increase by +2.2% from the same quarter last year.

Headlines

Economic growth moderated to 0.4% in Q1 2018, which is partly attributed to bad weather conditions and strikes in some euro area countries.

Unemployment rate in Q1 2018 was recorded at the lowest level observed since the Global Financial Crisis.

The ECB expects the recent strength in employment growth across the euro area to lose momentum as fiscal stimuli in certain Eurozone countries gradually fade out in 2018.

Growth was revised upwards after Germany recorded an above par expansion of +0.5% in the second quarter this year. Yet, readings are below the +0.7% growth observed throughout most of 2017, likely due to weaker exports, muted domestic demand due to lower confidence, higher inflation and reduced global trade.

Eurozone industrial production in June 2018 fell by -0.7% compared to the rise of +1.4% in May this year owing to decreased production of capital goods, non-durable consumer goods, intermediate and durable consumer goods. The 12-month figure increased by +2.5%, driven by a rise in civil engineering and building construction. The highest increases in industrial production among member states for which data was available, were recorded in Ireland (+7.7%), Romania (+7.0%), the Czech Republic (+6.9%) and Poland (+6.7%), while decreases were noted in Denmark (-1.2%), Portugal (-1.0%) and the Netherlands (-0.2%).

Retail trade volumes for June 2018 increased by +0.3% from May. This constitutes a 12-month increase of +1.2% in volume terms, driven by rising sales in food, drinks and tobacco. Over the 12 months to June 2018, the largest annual retail volume increases were registered in Romania (+7.8%), Lithuania (+7.2%), Hungary (+6.1) and Bulgaria (+6.0%). Highest decreases were noted in Malta (-1.5%), Austria (-1.4%) and Estonia (-1.2%).

FIGURE 2 **Winners and losers**

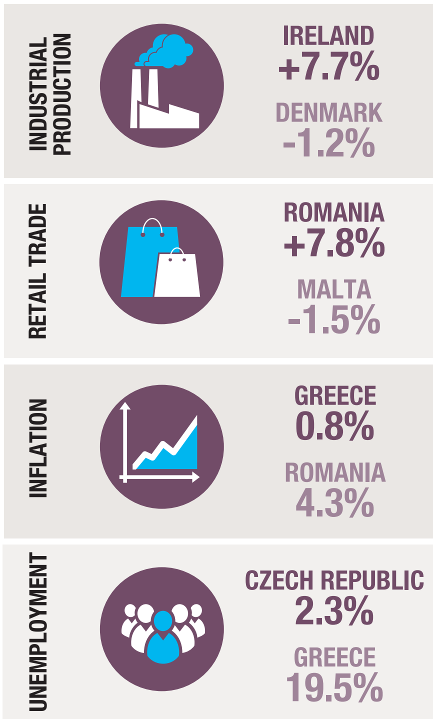
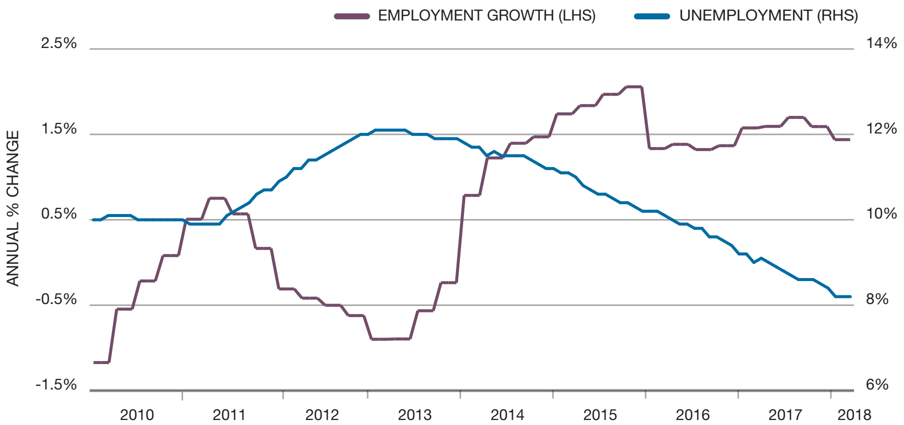
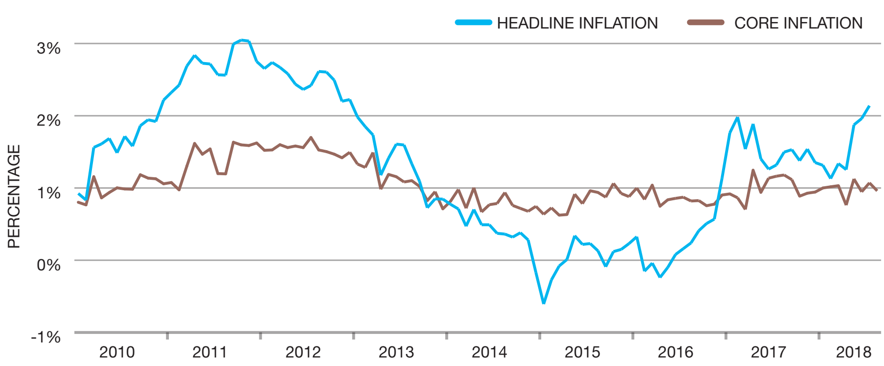


FIGURE 1
Eurozone unemployment falls as employment growth stabilises



Source: Macrobond, Knight Frank Research

FIGURE 3
Inflation is below 2% target



Source: Macrobond, Knight Frank Research

Annual inflation in the euro area rose to 2.1% in July 2018, from 2.0% in June, and is expected to return to 2.0% in August. A year ago the rate stood at 1.3%. The highest contribution to the annual inflation rate in July came from energy, followed by services, and food, alcohol & tobacco. The lowest annual inflation rates were recorded in Greece (0.8%), Denmark (0.9%) and Ireland (1.0%). Whereas Romania (4.3%), Bulgaria (3.6%), Hungary (3.4%) and Estonia (3.3%) showed the highest annual rates.

The Eurozone's unemployment rate stood at 8.2% in July 2018, unchanged from June and down from 9.1% in July 2017. The lowest unemployment rates in July this year were observed in the Czech Republic (2.3%), Germany (3.4%) and Poland (3.5%), while the highest were recorded in Greece (19.5%, May 2018) and Spain (15.1%).

The 10-year Eurozone government bond yields fell to just under 1.20% at the end of July, from 1.29% at the end of June, following the European Central Bank's minutes on keeping rates at record lows for as long as needed, while ending its bond-buying programme in December this year. This constitutes a 32bps increase from the December 2017 yields of 0.88%. The annualised IPD equivalent yield in the Eurozone was 4.33% in December 2017, 36bps lower than the year before; putting the arbitrage at 3.45% at the end of 2017.

The euro could be adversely affected by the trade talks currently taking place between the Eurozone and Washington. Trump has rejected the EU's free trade deal offer. The EUR/USD rate has fallen to 1.1600 as trade war fears weighed on most currencies except the dollar. Meanwhile, below-expectation manufacturing data, pared with May's Brexit plans facing increasing opposition from all sides, is putting pressure on the sterling. The pound to euro exchange rate is 0.40% lower at 1.1079.

"The euro could be adversely affected by trade talks currently taking place between the Eurozone and Washington, while the sterling is coming under pressure amid oppositions to May's Brexit plans and below par manufacturing data."

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