RESEARCH

EUROZONE ECONOMY

MARCH 2019

Eurozone GDP rose by 2.0% in the three months to Q4 2018, matching Q3's pace of growth, according to estimates.

Headlines

Eurozone GDP growth in Q4 2018 was weighed down by weaker manufacturing output and consumer spending

ECB maintained a dovish monetary policy and kept rates unchanged at historic lows

Second tier office markets like Spain could garner fresh interest

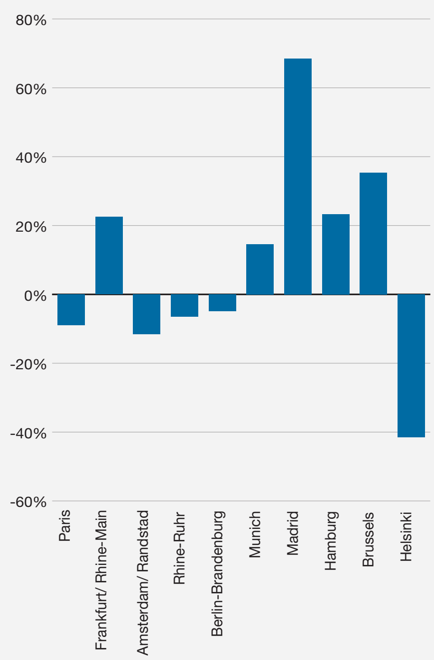
Year-on-year growth measured 1.1%. Over the whole year 2018, Eurozone GDP rose by 1.8% – a 0.6% slowdown from 2017. The lacklustre fourth quarter result can be attributed to a weak manufacturing sector and dampened consumer confidence.

Sentiment was not helped by the European Central Bank (ECB) downgrading its outlook for the euro area. The GDP growth forecast for 2019 has been revised to 1.1%, 0.7% lower than the Q4 2018 prediction. The ECB said: "The persistence of uncertainties related to geopolitical factors, the threat of protectionism, and vulnerabilities in emerging markets appear to be leaving marks on economic sentiment." The ECB's forward guidance pointed to a supportive monetary policy ahead, which should help to stabilise the economy.

Industrial production in January 2019 increased 1.4% month-on-month, but fell 1.1% year-on-year. The monthly production increase owed much to a rise in energy and non-durable consumer goods production, while the annual decrease was driven by a 4.0% drop in energy and a 3.0% decline in capital goods production. Over the year, Ireland (-6.2%), Luxembourg (-4.2%) and Germany (-3.4%) were the worst performers for industrial production Slovakia (+7.2%), Poland (+6.1%) and Lithuania (+5.9%) registered the strongest growth.

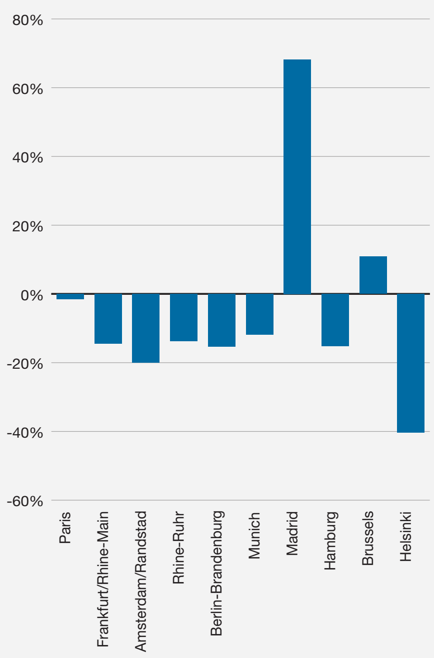
Retail trade was more buoyant: January 2019 registered an increase of 2.2% year-on-year. Trade volumes rose 1.3% compared with December 2018. Both increases were driven by automotive fuels and food & drinks and tobacco retail.

FIGURE 1
2018 Eurozone Office Volumes



Source: Real Capital Analytics

FIGURE 2
2018 Eurozone Office Floorspace



Source: Real Capital Analytics

The annual retail volumes showed that consumers were most inclined to shop in Slovenia (+11.0%), Ireland (+8.1%) and Romania (+6.7%), and least so in Finland (-1.3%) and Denmark (-0.3%).

The annual inflation rate in the euro area rose to 1.5% in February 2019, up from 1.4% in January 2019 and 0.4 percentage points higher than February 2018. Energy prices were the main driver. The ECB decided in March to hold interest rates at current historic lows in a bid to revive the weakening economy in the euro area. The bank's forward guidance suggests that rates could remain unchanged for the remainder of 2019. That said, any rises also depend on the sustainable convergence of inflation on the 2% target. Ongoing liquidity support to Eurozone banks in the form of a series of cheap loans should further stabilise sentiment and economic activity.

The unemployment rate in January 2019 remained stable at 7.8%, marking an almost ten-year low and beating the consensus forecast of 7.9%. On an annual basis, unemployment fell in all member states, except in Denmark and Malta, where unemployment remained unchanged. Cyprus, Greece and Spain registered the largest decreases.

The 10-year Eurozone government bond yield dropped 14 bps since the end of 2018 to 0.95% at the end of February 2019. This is 24 bps lower than February 2018.

Secondary office markets like Spain might shift into the limelight this year. The Bank of Spain upped its growth forecast to 0.6% in Q1 2019, indicating that the country's expansion is defying a broader European slowdown. The consumer-driven Spanish economy has been lifted by continued spending and steadily increasing employment. This manifested itself in the Eurozone's office transactions as reported by RCA. Madrid saw a 68% rise in office volumes and square feet transacted throughout 2018. This is double that of Brussels and three times more than registered by Frankfurt. With Spain expecting annual growth for 2019 to rise above euro-area average, investors may want to take advantage of the continued recovery in second-tier cities.

> "Forward guidance suggests that rates could remain unchanged for the remainder of 2019 with any rises depending on the sustainable convergence of inflation towards the 2% target."

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