Eurozone economic outlook brightens with nascent recovery confirmed

- Eurozone economy grew 0.3% in Q4
- Broad-based upturn of rising consumer and investment spending, plus trade boost
- Outlook brightens and investors bet on corporate upturn as ECB QE drives euro down

The euro area economy grew 0.3% in the final quarter of last year, confirming initial estimates that the region is pulling out of its malaise. With business survey data indicating that the upturn has extended into the first quarter of 2015 and the European Central Bank commencing its €60bn per month quantitative easing programme in March, the region’s outlook is the brightest seen since before the global financial crisis.

Growth outlook brightens

Growth projections for 2015 are being steadily upgraded, and investors are buying into the recovery story.

Most notable has been the upward revision to growth forecasts at the ECB, where GDP is now projected to rise 1.5% this year and 1.9% in 2016, with 2.1% growth pencilled-in for 2017.

The year certainly seems to have started reasonably well. An upturn in the Eurozone PMI to a seven-month high in February puts the region on course for at least another 0.3% expansion in the first quarter. Especially encouraging is the news that all four largest euro countries, Germany, France, Italy and Spain, are now expanding in unison, which should help improve the sustainability of the recovery for the region as a whole.

Inflation to pick up

Inflation is meanwhile expected to rise to 1.8% in 2017, buoyed by the anti-deflationary impact of QE, meaning the ECB’s bond-buying will be able to come to an end in late-2016. Bond markets have been pricing in higher inflation since the ECB announced its intentions to start QE, lifting from January’s lows, according to Markit data comparing yields on index-linked bonds with conventional bonds.

However, with government bond yields having fallen close to record lows in many cases as investors have anticipated the ECB’s decision to start QE, there are worries that the central bank’s bond buying may have limited impact on reducing yields further. Yields are in fact generally lifting slightly higher so far this month, according to Markit’s bond pricing data.

It is perhaps therefore in the equity markets where the biggest impact from QE and the burgeoning economic recovery for the euro area is likely to be seen. ETFs are already seeing record outflows from US equity exposures and record inflows into eurozone-exposed funds as investors bet on policy divergences driving corporate profits higher in the single currency area but lower in the US.

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The expected improvement in corporate performance is linked to the exchange rate. The euro has already slipped to an 11½ year low against the US dollar, dropping below $1.10 on Friday on the divergent policy outlooks for the two economies.

The weakening of the euro will help manufacturers in particular, which is currently the weak spot in the region’s upturn. Many areas of the services economy, buoyed in part by consumers feeling better off as prices fall, are already seeing robust growth, according to Markit’s detailed sector PMI data, published today.

**Broad-based upturn in fourth quarter**

In the detail, the second estimate of GDP growth of 0.3% from Eurostat puts the region’s economy 0.9% larger than a year ago and follows 0.2% growth in the third quarter.

Over the whole of 2014, euro area GDP rose 0.9%, reviving from the 0.5% downturn seen in 2013.

The fourth quarter upturn was broad-based, driven by a 0.4% rise in household consumption, most likely linked to falling prices, and a similar increase in investment spending (gross fixed capital formation). Trade also boosted the region’s economy, with exports up 0.8% compared to a 0.4% rise in imports.

Estonia saw the strongest growth in the fourth quarter, enjoying a 1.1% expansion, but Germany, by virtue of being the largest member state, was the main driver of the region’s upturn, with its economy growing an impressive 0.7%. Second-largest member state France meanwhile only eked out 0.1% growth. That was better than Italy, however, where the economy stagnated, though that represents an improved performance compared to the downturns seen in prior quarters.

Spain and the Netherlands also provided a material boost the eurozone economy, growing 0.7% and 0.5% respectively, as did Portugal with a 0.5% increase.

Not all countries joined in the recovery, however, with GDP falling in the troubled economies of Cyprus and Greece, dropping 0.7% and 0.4% respectively, while more modest downturns of 0.2% were also seen in Austria Finland.

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