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Economics Group

Jay H. Bryson, Global Economist
jay.bryson@wellsfargo.com • (704) 410-3274

Economic Activity in Eurozone Stagnated in Q2

The Eurozone's three largest economies (Germany, France and Italy) either stagnated or contracted in Q2. Will the ECB eventually ease policy further?

Underlying Growth Pulse in the Eurozone is Anemic

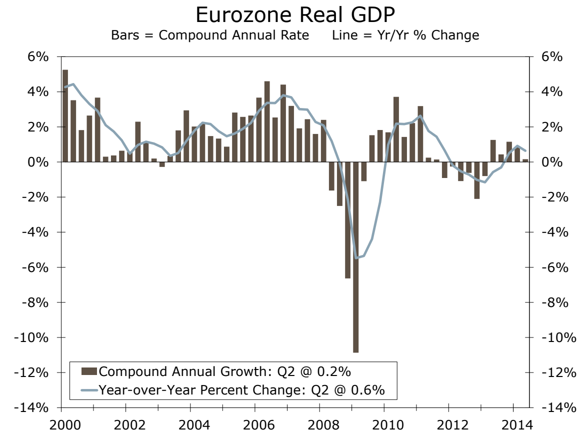
Data released this morning showed that real GDP in the 18 countries that comprise the euro area was essentially flat on a sequential basis in the second quarter (top chart). Although one weak quarter can sometimes be explained by transient factors—real GDP in the United States dropped 2.1 percent at an annualized rate in Q1 due, at least in part, to the severe winter—the 0.7 percent year-over-year GDP growth rate shows that the underlying pulse of economic growth in the Eurozone is anemic.

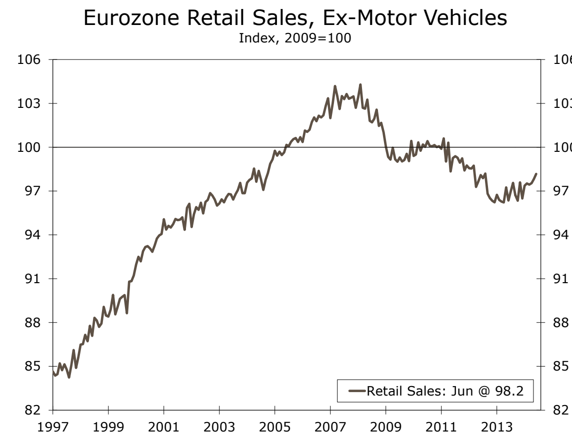
The weak outturn in the second quarter was foreshadowed last week when Italian statistical authorities announced that real GDP in that country fell 0.2 percent (not annualized) on a sequential basis in the second quarter. Data released today showed that real GDP in France was flat again in the second quarter. Moreover, real GDP in France was up only 0.1 percent on a year-ago basis in Q2, showing that the French economy has stagnated over the past year. The German economy, which has been the growth engine of the Eurozone over the past few years, contracted 0.2 percent (not annualized) in Q2 relative to the previous quarter. Without growth in Spain, (where real GDP rose 0.6 percent in Q2), and the Netherlands (up 0.5 percent) the overall euro area result would have been even weaker than it was.

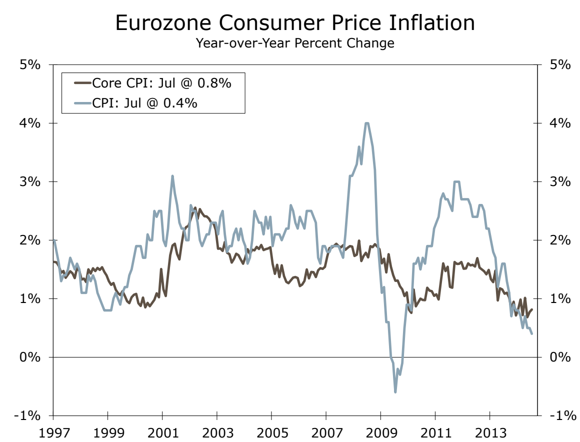
A breakdown of euro area real GDP into its underlying demand components will not be available until next month. Real consumer spending in the Eurozone likely edged higher in second quarter, but monthly data on retail spending suggest that the growth pulse remains weak (middle chart). Investment spending probably contracted in Q2, and with uncertainties related to the Russian-Ukrainian crisis still high, the outlook for capex does not appear to be positive. Indeed, the Eurozone economy likely will continue to limp along for the foreseeable future.

Will the ECB Ease Further?

With CPI inflation already barely above zero percent—in July consumer prices in the euro area were up only 0.4 percent on a year-ago basis (bottom chart)—weakness in real GDP will not do much to alleviate concerns that the Eurozone is on the cusp of slipping into a mild deflationary environment. For now, the European Central Bank (ECB) appears content to bide its time, waiting for the program that is intended to jumpstart bank lending to kick in later this year. However, if growth momentum in the euro area continues to wane or if CPI inflation falls even further, the ECB may be forced to act. Until now, the ECB has appeared to be reluctant to engage in a Fed-like program of quantitative easing (QE). However, events may ultimately force the ECB's hand. QE in the Eurozone, should it occur, likely would weigh on the euro.







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Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah Watt House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Michael T. Wolf	Economist	(704) 410-3286	michael.t.wolf@wellsfargo.com
Zachary Griffiths	Economic Analyst	(704) 410-3284	zachary.griffiths@wellsfargo.com
Mackenzie Miller	Economic Analyst	(704) 410-3358	mackenzie.miller@wellsfargo.com
Erik Nelson	Economic Analyst	(704) 410-3267	erik.f.nelson@wellsfargo.com
Alex Moehring	Economic Analyst	(704) 410-3247	alex.v.moehring@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com

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