February 13, 2015

Economics Group

Jay H. Bryson, Global Economist
jay.bryson@wellsfargo.com • 704-410-3274
Zachary Griffiths, Economic Analyst
zachary.griffiths@wellsfargo.com • 704-410-3284

Is an Economic Upswing Underway in the Eurozone?

Eurozone GDP growth outpaced consensus expectations in the fourth quarter, increasing 0.9 percent year-over-year. With the ECB beginning its own quantitative easing program, we look for further growth ahead.

Germany Drives Upside Surprise in Eurozone

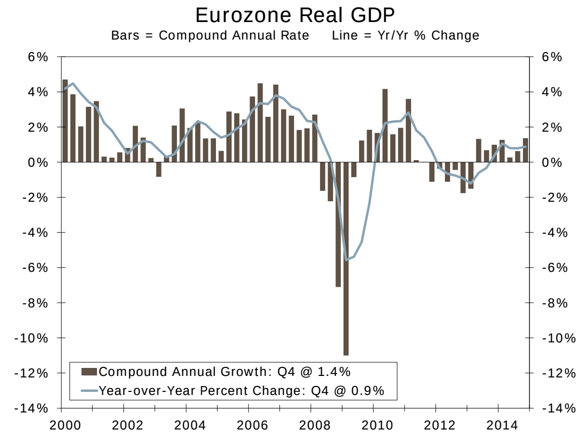
Data released this morning showed that real GDP in the Eurozone rose 0.3 percent (1.4 percent at an annualized rate) in Q4-2014 relative to the previous quarter. The stronger-than-expected outturn for the overall euro area—the consensus forecast had anticipated a 0.2 percent rise—was due largely to growth in Germany, where real GDP surged 0.7 percent. Elsewhere, growth was less impressive, as France grew just 0.1 percent, while Italy remained flat following two quarters of negative growth rates.

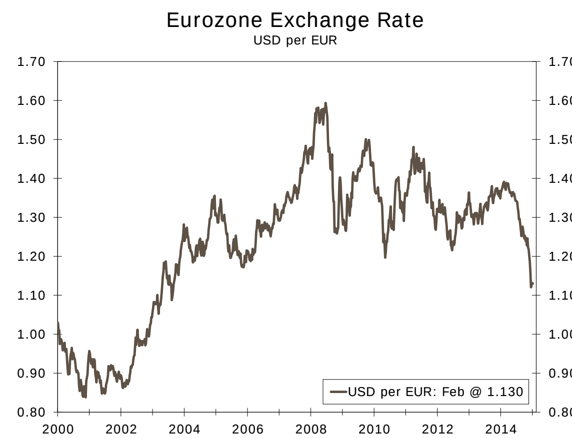
A breakdown of real GDP into its underlying demand components will not be available until next month, but it appears that stronger domestic demand contributed to the acceleration in real GDP. For example, monthly data show that real retail sales in the Eurozone rose 0.6 percent on a sequential basis in Q4, up from the anemic increase of only 0.1 percent that was registered in Q3. German statistical authorities indicated that investment spending also was strong in that country during Q4.

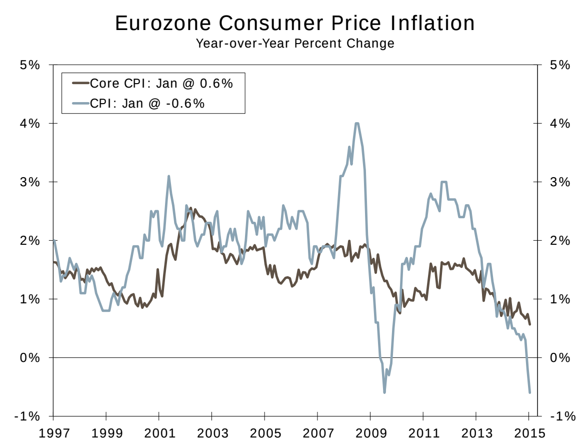
As shown in the top chart, the rate of GDP growth in the Eurozone has edged higher for two consecutive quarters, and we look for economic activity to strengthen a bit more this year. As we wrote in a recent report, the Eurozone has a few tailwinds in its favor now including lower petroleum prices, which should help boost real consumer spending, euro depreciation (middle chart) and relaxation in financial conditions. (See "*The Eurozone: The Good, the Bad, and the Ugly*")

That said, economic growth is not strong enough, at least not yet, to arrest the disinflationary momentum that has developed in the overall euro area. As shown in the bottom chart, overall CPI inflation has moved further into negative territory, as the collapse in oil prices weighs on global inflation rates. However, core inflation has remained relatively resilient over the past months, as falling oil prices have yet to drop core inflation into negative territory. That being said, core inflation is still below one percent, as the disinflation story is not limited to just energy prices. Concerns over lower inflation are part of the reason the ECB moved to sovereign bond purchases, which will total just shy of €60 billion per month. In that regard, we look for the euro to continue its recent decline, as monetary policy divergence weighs on the euro going forward.

We look for stronger growth going forward as the effects of quantitative easing take hold, but downside risks still remain. Among these downside risks is the potential for a "Grexit"—a Greek exit from the Eurozone. While we do not see this as imminent, (see *"Potential Financial Fallout from 'Grexit'"*) it is a potential outcome that would have negative effects on the Eurozone economy. The situation in Ukraine also remains fluid and further deterioration would have adverse effects on the Eurozone economy. We remain broadly positive on near-term prospects for economic growth, as long as no major exogenous shocks are realized.







Source: IHS Global Insight and Wells Fargo Securities, LLC

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