April 29, 2016

Economics Group

Jay H. Bryson, Global Economist
jay.bryson@wellsfargo.com • (704) 410-3274
Erik Nelson, Economic Analyst
erik.f.nelson@wellsfargo.com • (704) 410-3267

Eurozone GDP Growth Tops Expectations in Q1

Real GDP in the Eurozone grew 0.6 percent in Q1, besting the consensus estimate. Despite solid growth, inflation remains weak, suggesting monetary policy needs support from other policy areas.

Solid Quarter but Expansion Remains Modest

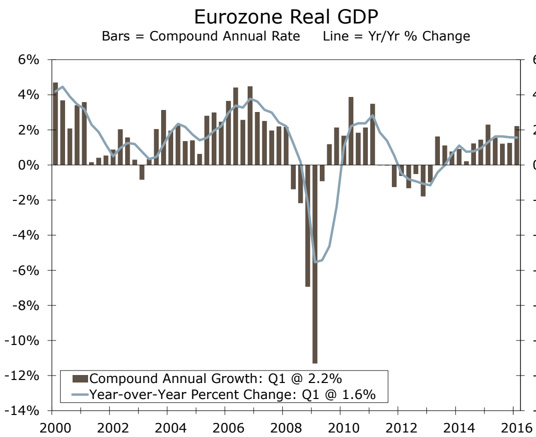
Data released this morning showed that real GDP in the Eurozone rose 0.6 percent on a sequential basis in Q1 (2.2 percent on an annualized basis, top chart). Not only did this reading top most analysts' expectations, but it also matched the strongest sequential pace of growth in the current euro area expansion. That said, the year-over-year pace of growth has held steady at 1.6 percent for the past four quarters, suggesting the expansion in activity remains fairly modest.

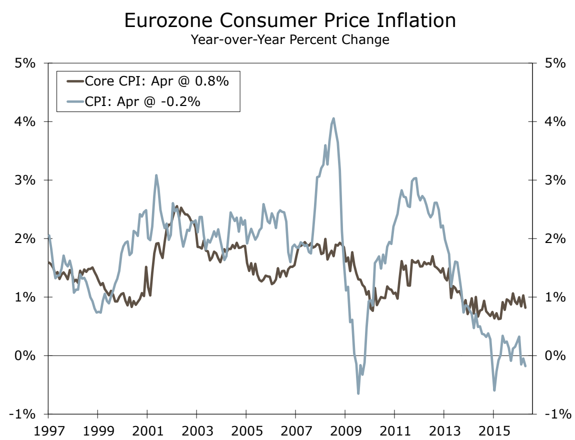
This morning's GDP release is earlier than usual (this marks the first quarter of "flash estimates" for Eurozone GDP growth), and thus we do not have a breakdown of the data into its production-side or demand-side components. However, higher frequency data suggest the expansion in the first quarter was fairly broadly based. In particular, retail sales volumes in the euro area advanced at a 3.4 percent annualized pace in the first two months of the quarter, while industrial production ex-construction climbed at a 4.3 percent annualized rate over the same time period. In that regard, growth in personal consumption and fixed investment spending was likely relatively robust in Q1.

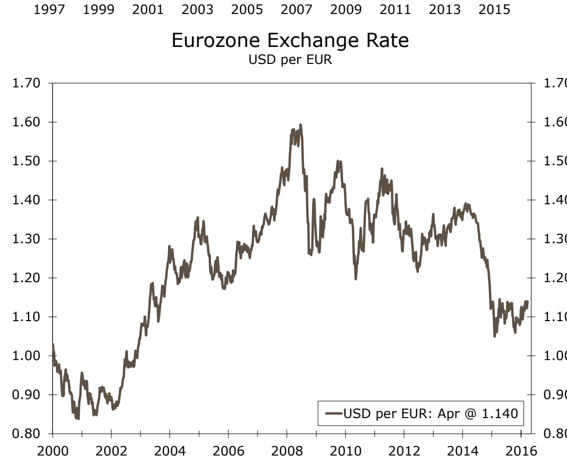
Few Signs of Inflation in the Euro Area

In a separate report this morning, we learned that the CPI declined 0.2 percent on a year-over-year basis in April, while core inflation downshifted to just 0.8 percent (middle chart). These soft inflation data will likely be viewed with disappointment by European Central Bank (ECB) policymakers, as they have adopted an extraordinarily accommodative monetary policy stance for the past several years in an attempt to achieve inflation "below, but close to, 2 percent." The ECB made no change to its policy stance at its April meeting, but it cut all three of its policy rates at its March meeting. Moreover, it ramped up its monthly pace of asset purchases under its quantitative easing (QE) program to €80B/month in March and broadened the array of assets available for purchase.

As we have written, the persistent lack of inflationary pressures in the Eurozone despite increasingly accommodative monetary policy suggests that these monetary measures help at the margin, but are not a "silver bullet" for the euro area economy.[1] In its prior two statements, the ECB has called upon other policy areas to contribute more decisively in order to reap the full benefits from accommodative monetary policy. In particular, the statements have called for structural policies to "raise productivity and improve the business environment," while also suggesting that fiscal policy should support the recovery as well. In our view, the ongoing economic recovery in the Eurozone likely will remain modest and inflation likely will be subdued until other policies become more supportive of growth.







Source: IHS Global Insight and Wells Fargo Securities, LLC

[1] **See "The ECB Attempts to Shock and Awe," (March 10, 2016), which is available on our website.**

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
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Jamie Feik	Economist	(704) 410-3291	jamie.feik@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
Misa Batcheller	Economic Analyst	(704) 410-3060	misa.n.batcheller@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Julianne Causey	Economic Analyst	(704) 410-3281	julianne.causey@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

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