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Economics Group

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Eurozone GDP Edges Higher in Q4 2015

Real GDP growth in the Eurozone remained modest in Q4, rising only 0.3 percent. Facing soft growth and minimal inflationary pressures, the ECB may choose to ease policy further at its next meeting.

Broad-Based Weakness

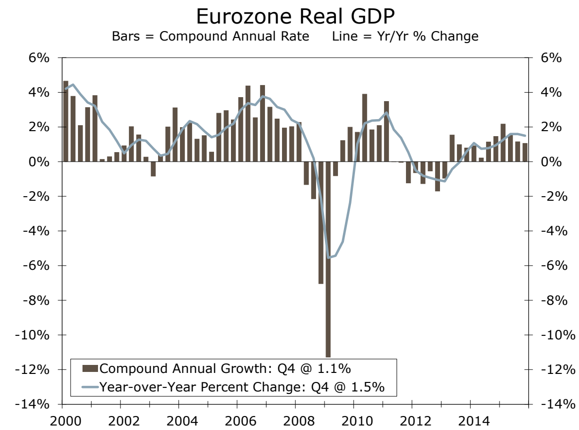
Data released this morning showed that the Eurozone economy grew just 0.3 percent on a sequential basis in Q4 2015, in line with expectations. The weak reading brought the year-over-year rate of growth down slightly to 1.5 percent, while the economy grew just 1.8 percent in full year 2015. A breakdown of real GDP into its underlying demand components will not be released until early March, but monthly data give us some more insights into the underlying state of the economy.

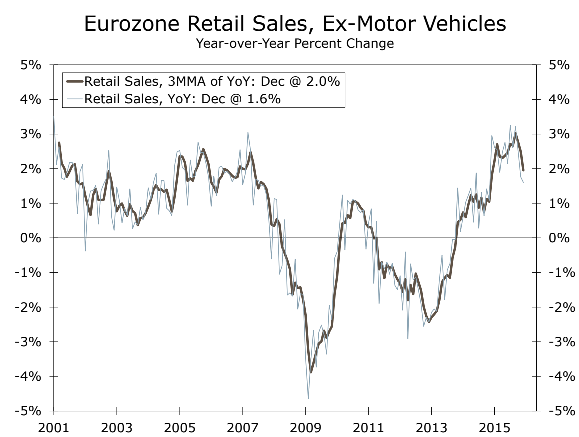
Industrial production (IP) in the Eurozone fell 0.1 percent (not annualized) in Q4 relative to Q3. Yes, unseasonably warm weather depressed utilities production and contributed to the sharp monthly declines in IP in November (0.5 percent) and December (1.0 percent). However, the underlying pace of manufacturing production was also anemic, which likely reflects, at least in part, weakness in real exports as well as in investment spending. GDP growth in the Eurozone has been paced recently by modest growth in consumer spending, and the sharp increase in car registrations that occurred in Q4 suggests that consumer purchases of durable goods were solid. That said, excluding motor vehicles, retail sales growth showed some signs of slowing as the year drew to a close (middle chart).

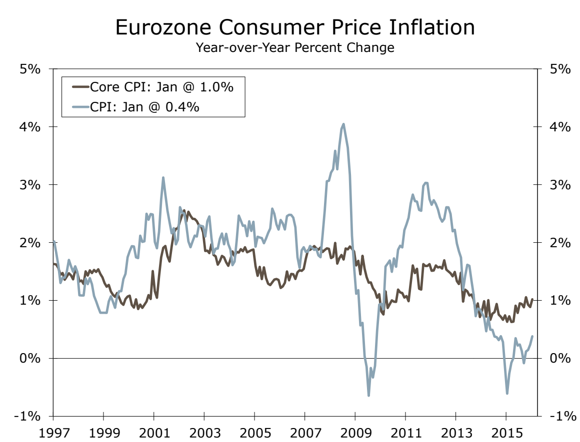
Implications for ECB Policy

While the broader expansion in euro area economic activity remains in place, the 1.5 percent year-ago growth rate registered in Q4 is hardly a blockbuster pace, and has not been strong enough to stoke sustained inflationary pressures in the region. Indeed, CPI inflation is well below the ECB's objective of "below but close to two percent," and the core rate remains relatively anemic at present as well (bottom chart). Meanwhile, ECB policymakers' preferred measure of inflation expectations has fallen sharply over the past two months, and recent financial market volatility means that risks to the real GDP and inflation outlooks are probably skewed to the downside.

In light of these concerns, ECB President Draghi has stated that the current monetary policy stance would be reevaluated at the bank's March meeting, leaving the door open to further monetary stimulus. The ECB has had a negative deposit rate (-0.30 percent) for more than a year and a half now, meaning it charges commercial banks 30 bps to hold excess reserves at the central bank. Meanwhile, it is also purchasing €60 billion worth of sovereign bonds per month. While it is unclear at this time what form additional monetary stimulus would take, we expect policy will become more accommodative in coming months. Given our expectation for further modest interest rate hikes from the Federal Reserve, our currency strategists expect the euro to weaken vis-à-vis the greenback over the medium term.







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