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Economy

Broadening of the Eurozone's recovery

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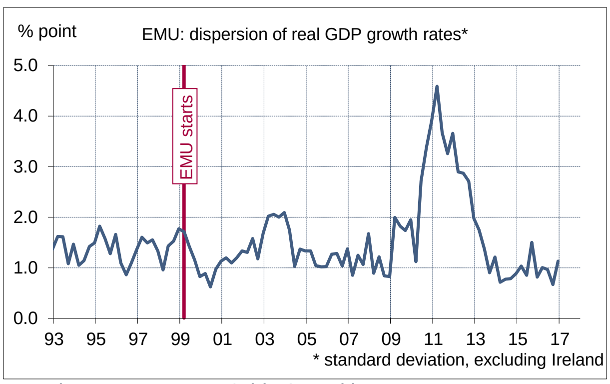
When the first signs of the Eurozone recovery emerged a few years ago, Mario Draghi described the upturn as "weak, fragile and uneven". Since then, he has regularly repeated this point, notably to justify the ECB adopting new monetary easing measures. The recovery is now stronger and more solid, but more significantly, it shows that Eurozone member states are converging once again. The movement is slow, admittedly, and does not yet offset the fragmentation observed during the years of crisis but it does reflect a significantly larger base for the economic recovery of the European continent.

Reconvergence

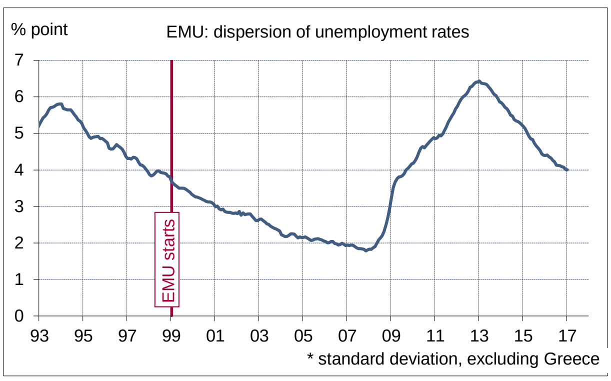
At end-2013, the nascent recovery in the Eurozone was described by Mario Draghi as "*weak, fragile and uneven*"[1]. We are tempted to invert this formula term by term at present.

- ~~Weak~~ Strong recovery – In 2014, real GDP for the Eurozone rose by 1.2%, vs 2.1% per annum in the decade before the financial crisis. In 2015 and 2016, growth averaged 1.8% per annum, which remains modest, but several business confidence indices point towards a marked acceleration in the near future (See our *Economic Note* of 24 March: "*Escape velocity* for European growth")
- ~~Fragile~~ Solid recovery – After the double dip of 2012-2013, the upturn first appeared to be technical (recessions do not last forever) and benefiting from positive external factors. Thus the oil countershock simultaneously led to a reduction in the oil bill and a firming of the dollar, which was positive for households' purchasing power and the competitiveness of exports. Despite the potentially negative external shocks such as Brexit, terrorism, or the migrant crisis, the economy held up, which, in itself, is a sign of resilience. Henceforth, it is employment and credit, two fairly inertial phenomena, which are stoking the recovery.
- ~~Uneven~~ Broadened recovery – A recession is a problem in itself as it triggers a rise in unemployment and defaults, but this problem is compounded in a monetary union if macro trends amongst member states diverge. This is what happened as of 2008. The divergence peak is now behind us. The disparity between the growth rates has normalised (chart lhs), the disparity in unemployment rates has not yet normalised but is narrowing (chart rhs). **This is the start of a new convergence between the member states of the Eurozone.**

Eurozone: dispersion of growth rates



Eurozone: dispersion of unemployment rates



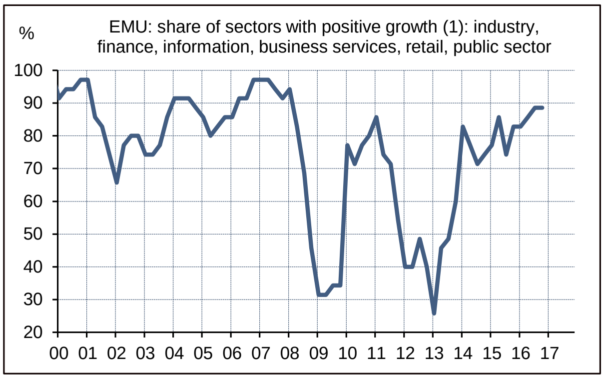
Source : Thomson Reuters, Oddo Securities

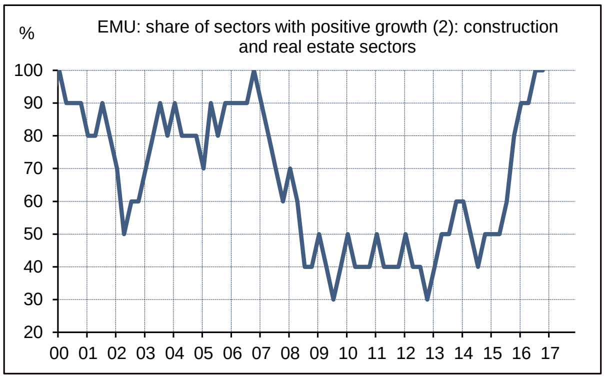
[1] *Mario Draghi's press conference, on 2 October 2013 ("We view the recovery as weak, as fragile, as uneven.")*

If one of the goals of monetary union is to foster convergence between countries – and symmetrically, if convergence between countries is a condition of the smooth functioning of monetary union – we see that the divergence observed as of 2008 could have been fatal to the euro project. Conversely, it is encouraging to see that the rebound in activity is expanding both geographically and at the sector level. There are still, however, differences between Eurozone member states. France has struggled to hitch its wagon to the recovery train but the brightening of economic conditions is now proven. Italy indisputably continues to lag behind. Regarding the sectors, the widening of the recovery is even more marked, which Mario Draghi has repeatedly highlighted in his last two press conferences on the evidence provided by this staff's reports[2].

National accounts break down economic activity into nine major sectors for each of the Eurozone countries. We can therefore calculate the proportion of sectors which are simultaneously in a growth phase. This share is now close to 90%, a usual level for an expansionary phase. It had fallen to around 30% in 2009 and 2013. To more effectively illustrate this point, it is useful to differentiate between sectors linked to construction and the other sectors. Excl. construction, activity conditions normalised as of 2014 (chart lhs). **The new element of the current recovery relative to the abortive attempt of 2010 is the rebound in construction and property development**. At end-2016, these two sectors reflected growth in all regions[3]. Such a synchronised rebound has only materialised twice in the past, each time for a brief period, in 2000 and in 2006 (chart rhs). That said, the construction sector was mired in crisis for such a long period that the current rebound is far from having made up the lost output. At present, the volume of construction activity is 3% lower than its 2008 peak in the Eurozone whilst total GDP has exceeded its pre-crisis peak by more than 2%. As the output gap in the construction sector narrows, the rate of unemployment will continue to fall because construction is a labour-intensive activity for which there are few possibilities for offshoring.

Eurozone: share of sectors with positive growth (calculation based on Germany, France Italy, Spain, rest of the Eurozone)





Sources: Thomson Reuters, Oddo Securities

All told, **since mid-2013, the rise in real GDP has come exclusively from domestic demand, with in order of importance, household consumption (contribution of 52%), investment (32%) and public consumption (17%).** This situation has every reason to last due to the decline in unemployment, growth in bank loans in the private sector and the return of public accounts to a situation closer to equilibrium in a majority of Eurozone countries. Over the same period, the blackspot has been external trade: net exports have added nothing to GDP growth. They even trimmed growth slightly in 2016 (-0.2 points), which had not happened since 2009. However, the reflation of oil and industrial prices could, by easing financial constraints in emerging markets, facilitate a rise in demand for European goods and trigger a modest positive contribution from net exports in 2017. **It is therefore a widening of the base of the European recovery which we are witnessing at the start of 2017**.

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[2] *See ECB (2017), "Economic growth in the euro area is broadening", Economic Bulletin 2/2017*
[3] *In order to have relatively homogeneous entities, we consider the four major economies individually (Germany, France Italy, Spain) and the group the other fifteen EMU countries together.*

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