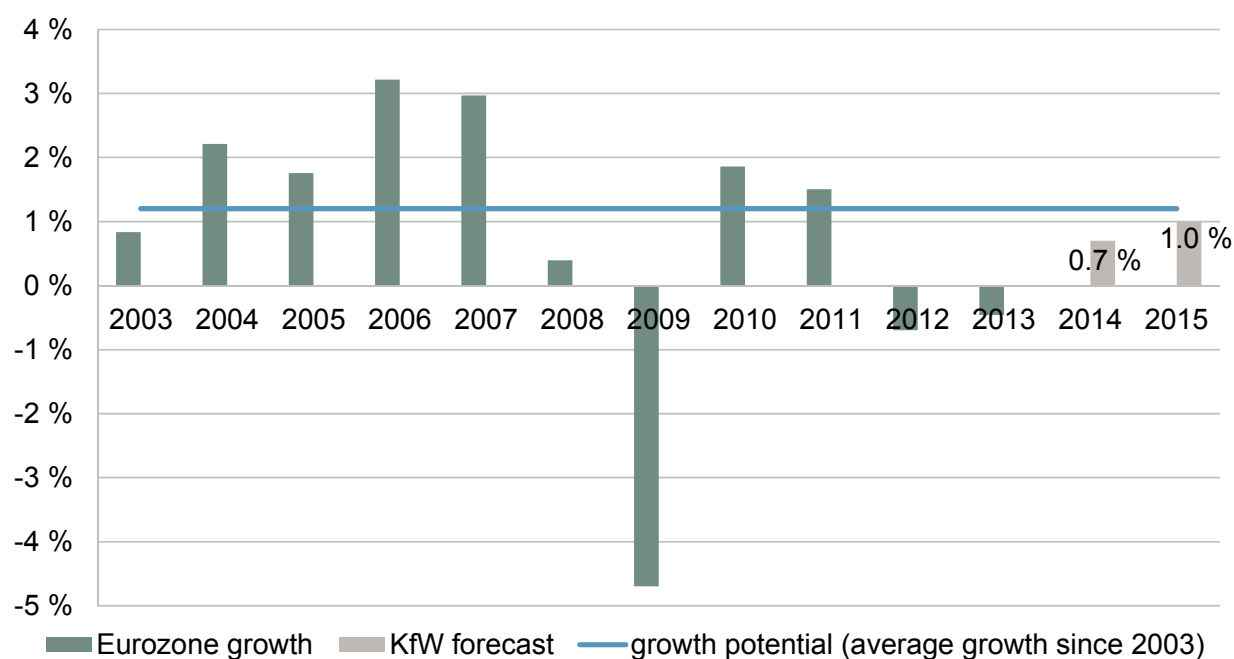


KfW Business Cycle Compass Eurozone

Growth insufficient to boost employment and investment

- *The eurozone grew slightly again in the third quarter of 2014, up by 0.2% compared to the previous quarter. Assuming a similar pace until the end of the year, the eurozone will end 2014 with a growth rate of 0.7% (adjusted for prices).*
- *KfW is sticking by its forecast of 1.0% for 2015. This expansion should be driven primarily by private consumption and exports, which benefit from the lower energy prices and the cheaper euro.*

Real gross domestic product growth in the eurozone



Sources: AMECO, KfW Research

Listless third and fourth quarter

The eurozone economy has ground to a halt. Growth of gross domestic product (GDP)¹ amounted to 0.2% in the third quarter of 2014 compared to the previous quarter, while the pace of expansion in the second quarter was revised upwards to 0.1%. This means the eurozone is fortunately more stable than was previously feared. Private consumption is likely to have made a moderately positive contribution to this growth again. This at least is what the continued modest reduction in unemployment would seem to suggest. The balance of trade

¹ GDP figures and their individual components at eurozone level are adjusted for price and seasonal factors, as reported by Eurostat.

in goods and services rose by 2.1 % (in nominal terms) in the third quarter compared to the previous quarter, which indicates a positive contribution by net exports. Gross fixed capital formation, changes in inventories as well as government expenditure are likely to have been neutral or marginally negative taken together. We expect this development will continue in the fourth quarter, which means the growth rate for 2014 as a whole should ultimately come in at 0.7 %.

Looking ahead: KfW forecast for 2015

For the coming year we expect somewhat higher growth of 1.0%. New orders in the eurozone's manufacturing industry have been rising steadily for six quarters in a row, and have by now recovered the levels of 2011. This stabilises the labour market and hence bolsters private consumption. Replacement investments by companies are needed more quickly as well. Net exports should remain positive next year too. Exports are supported by the weaker euro exchange rate, while in terms of imports the low oil price is beneficial for the eurozone. Private consumption also profits from the lower energy prices.

Based on this forecast we will need to wait another year for the economic upturn, as fiscal policy is too pro-cyclical, unemployment is still much too high and the overall conditions for companies are much too uncertain. The reform countries in particular are likely to stand out positively. Pent-up demand coupled with improved access to financing should ensure somewhat more dynamic economies there.

Spain delights, France surprises and Italy disappoints

Looking at the "big three" behind Germany, Spain currently offers the most encouraging economic development, but France put a marker out there too with a growth rate of 0.3 % in the third quarter. Italy, by contrast, has slipped into recession, at least technically, following its second quarterly contraction in a row. We do not expect any fundamental reshuffling of relative economic strengths in 2015.

Risks remain: winter, exchange rates and global politics

The risks are somewhat more balanced than just a few months ago, which is good news. The progress made by the reform countries, including Greece, means that we can no longer rule out surprises on the upside. That said, there is still significant potential for setbacks. A harsh winter that constrains growth more than usual would become a millstone around the eurozone's neck for the rest of the year. The weak euro is a prerequisite for more dynamic exports. Yet this is also dependent on other large central banks, which have not yet marked out their course for 2015. The eurozone's economic relationship with Russia is in upheaval, which comes with its own unwanted risks.

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