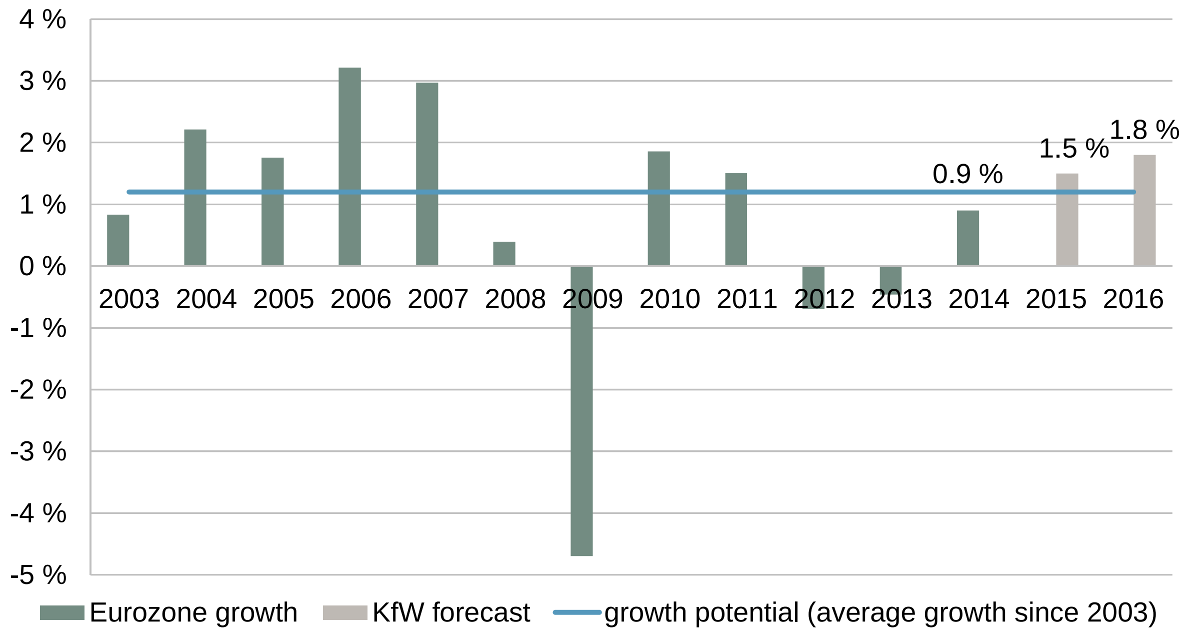
Frankfurt, 23rd September 2015

KfW Business Cycle Compass Eurozone

Moderate upswing continues

- ***Seasonally adjusted gross domestic product in the eurozone grows by 0.4% in real terms during the second quarter of 2015.***
- ***A weaker euro and falling unemployment are stimulating the economy. The new aid programme for Greece brings calm.***
- ***KfW Research raises its growth forecast for this year to 1.5% and expects the economy to gain additional momentum next year (2016 forecast: 1.8%).***

Real gross domestic product growth in the eurozone



Source: AMECO, KfW Research

Positive growth trend continues

Growth was stable in the eurozone this spring – during the second quarter of 2015, seasonally adjusted real gross domestic product grew at a rate of 0.4% compared with the previous quarter and was therefore almost as strong as at the start of the year.

The current growth has a broad basis: Apart from France, whose economy stagnated, every economy within the eurozone expanded. Growth in Germany was robust, while Spain's positive result was a particular high point – at 1.0%, its GDP grew more rapidly than at any time since 2007. There is light at the end of the tunnel again for Italy too, after its economy grew over two consecutive quarters for the first time in four years.

Depreciation of euro jump-starts foreign trade

The upturn in the eurozone was predominantly driven by exports, which contributed 0.3 percentage points to growth. In contrast with the previous quarter, however, domestic demand painted a mixed picture. While private and public consumption continued to gather momentum, the economy was held back by a decline in gross fixed capital formation.

The most recent economic data for the eurozone confirms a moderate upswing and in some cases even shows that performance was better than expected. Because of this, we have raised our growth forecast for 2015 to 1.5 %, placing our estimate slightly above the long-term average growth rate in the eurozone.

The euro exchange rate has fallen sharply relative to the eurozone's main trading partners since the beginning of last year and hence exports have gained more momentum than forecast. Exports had already grown by 1.0 % at the start of the year but in the second quarter they again rose considerably, by 1.6 %, even surpassing growth in imports. Rising foreign demand is also affecting the labour market. The unemployment rate in the eurozone fell to 10.9 % in July, 0.7 percentage points lower than in the previous year. Unemployment in Italy fell particularly sharply in July, ending 0.5 percentage points lower than in the previous month.

Rising retail sales and signs of positive business sentiment suggest that consumer confidence remains strong and households are feeling the benefits of further oil price falls in their pockets. Private consumption may also support growth in the second half of the year. Increasing numbers of people with jobs, who are willing to spend more, have the effect of consolidating tax revenues, relieving the burden on social security systems and allowing governments more leeway for investment. The funds released by the Juncker Plan are also expected to boost investment.

Last but not least, policy-makers within the currency union managed to avoid a Grexit and set in motion another bailout package. Although wrangling about the future shape of the eurozone is only just beginning and no enduring solution has yet been found for Greece, this agreement strengthens confidence in the eurozone's ability to take action and creates more unity.

The road to normality remains rocky

We are maintaining our estimate of GDP growth in the eurozone at 1.8 % for 2016. There are still a number of obstacles to stronger growth. First of all, unemployment continues to be too high. Added to that, inflation remains weak, which will make it harder to consolidate public finances. We should not lose sight of the fact that, despite some positive news, it is too early to celebrate and, in the second quarter of 2015, the eurozone's economy only returned to the level it was at in the middle of 2008.

Risks remain balanced

The risks associated with our forecast remain balanced. Further stimulus as a result of falling oil prices or a decline in the euro exchange rate could have a positive impact. In terms of downside risks, concerns about a greater than expected weakening of the global economy, sparked by stock market turbulence in China, are gaining more prominence. From a political point of view, a series of forthcoming elections in the eurozone (Greece, Portugal, Spain, France) may generate increased uncertainty.

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