PANTHEON MACROECONOMICS

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THE WEEKLY EZ ECONOMIC MONITOR

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Upbeat data in Germany and France add further evidence of a Q1 recovery in EZ consumers' spending.

The German labour market data are still rock-solid, but they will soon begin to deteriorate.

All set for a dip in EZ core inflation today; look for a big decline in the services CPI.

More Evidence Emerging of a Q1 Rebound in Consumers' Spending

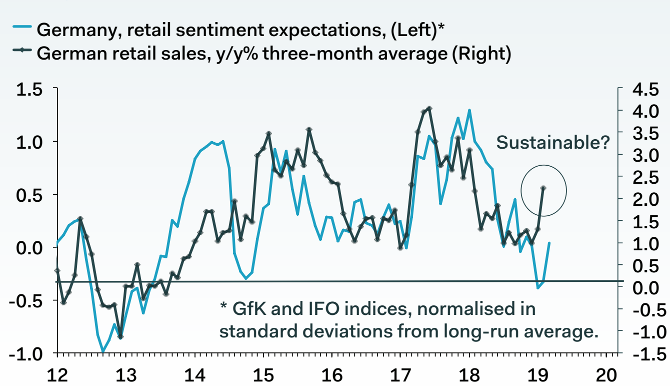
Friday's economic data added to the evidence of a Q1 rebound in EZ consumption growth. In Germany, retail sales rose by 0.9% month-to-month in February, an impressive gain after the revised 2.8% jump in January. The year-over-year rate soared by 1.6 percentage points to 4.7%. *The details tell a story of a sharp rebound in demand for consumer goods at the start of the year.* Sales of clothing and shoes and cosmetics accelerated, despite already strong growth in January, while spending on furniture and IT slowed.

Our first chart shows that sales growth is now running well ahead of the pace implied by the IFO and the GfK indexes. This is not unusual. The German retail sales data are extremely volatile, and we are pretty certain that the average year-over-year rate of 3.7% over January and February is a good deal higher than the true trend. We are *also* confident, however, that consumption growth is turning up, after slowing for most of last year, and the retail sales data support this claim. *Our base case is that sales jumped 1.5% quarter-on-quarter in Q1, accelerating from a 0.5% rise in Q4, pointing to clear upside risks to consumers' spending.*

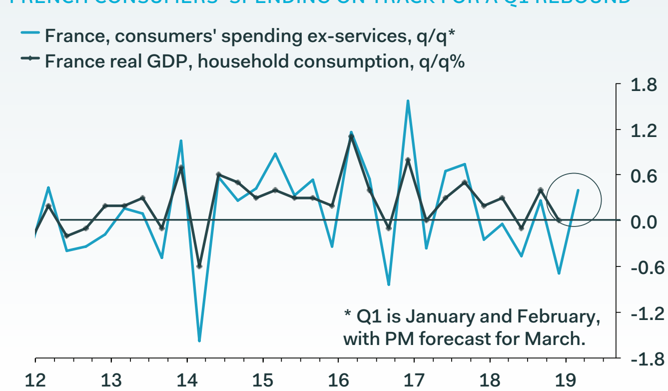
This upbeat message from Germany is reinforced by the French data. Consumers' spending fell 0.4% month-to-month in February, but this followed an upwardly-revised 1.4% leap in January, indicating a solid start to the year overall. The year-over-year rate sank to -1.8%, from a revised +1.1%, thanks mainly to base effects. The headline was primarily constrained by a 3.3% decline in energy consumption, due to unseasonably high temperatures. This partly reversed the jump in January, which was unusually cold. The remaining details, though, were solid. Durable goods consumption remained robust, though it slowed from a jump in January, while spending on clothing accelerated.

Base effects mean that the quarter-on-quarter rate likely will be less impressive than in Germany, but we are still looking for a 0.4% increase, a significant rebound after the 0.7% decline in Q4. This forecast assumes a 0.7% month-to-month increase in March. *Our next chart shows that this ought to be enough to drive overall spending growth higher, after a flat Q4.*

SOLID, BUT GERMAN RETAIL SALES ARE GETTING AHEAD OF REALITY



FRENCH CONSUMERS' SPENDING ON TRACK FOR A Q1 REBOUND



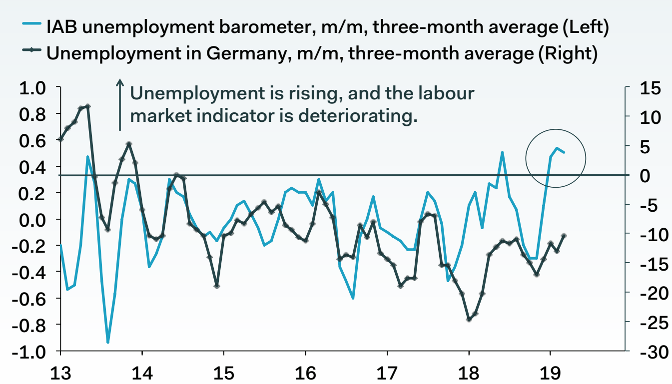
A shift ahead in Germany's labour market?

In other economic news on Friday, the headline German unemployment rate dropped to a new cyclical low of 4.9% in March, from 5.0% in February, driven by a 7K decline in unemployment claims. Vacancies edged higher by 2K, and have now fully reversed the small decline in the second half of last year. Employment—reported for February—rose 1.1% year-over-year, the same pace as in January. *These are sizzling data, which confirm the story that the German economy is close to full employment, and that wage pressures are building.* Wages—part of total employee compensation—rose 4.4% year-over-year in Q4, slowing from a 5.0% increase in Q3, but the tightness of the labour market suggests that growth will re-accelerate soon.

The short-term story in Germany's labour market, however, likely is about to shift dramatically. GDP growth plunged to 0.6% in Q4 2018 from 2.8% year-over-year in Q4 2017; this will drag employment growth down with a lag. *We are fairly confident that employment growth will slip below 0.5% year-over-year in the next two-to-three quarters.*

Leading indicators for unemployment claims tell a similar story. Our next chart shows that the labour market institute's unemployment index has deteriorated in recent months, warning that jobless claims could well be rising slightly towards the end of Q2. Manufacturers are most likely to respond to the recent slump in activity by shedding workers—especially part-time labour—while services and construction should remain robust. ***In total, we think that the headline unemployment rate will remain unchanged for the rest of the year.***

GET READY FOR SOME LESS UPBEAT GERMAN JOBS NUMBERS

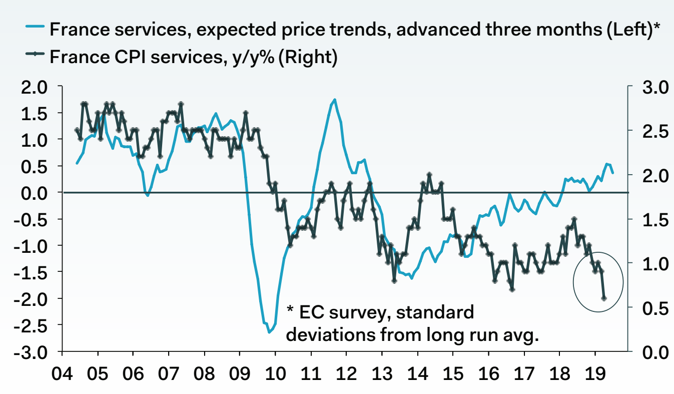


A correction, and a look to today's EZ CPI data

In Friday's *Monitor*—see here—we erroneously said that German headline inflation was unchanged at 1.5% in March. It wasn't. It *fell* by 0.2pp to 1.3%, pulled down by lower food and core inflation, which offset a rise in energy inflation. Adding insult to injury, the EU's headline HICP rate was later corrected downwards, by 0.1pp, to 1.4%. We apologise for these errors. ***Our estimate for the 0.5pp fall in the German HICP core rate, to 1.1%, is intact, however, warning of a downside surprise in today's EZ data.*** We think core inflation in the euro area slipped to 0.8% in March, 0.2pp lower than in February, and below the consensus 0.9%. The headline rate likely dipped by 0.2pp, to 1.3%.

This story was all but confirmed by Friday's French CPI data. Headline inflation declined by 0.2pp, to 1.1%, primarily thanks to a 0.3pp fall in services inflation to 0.6%. The advance report brings no details, but we are confident that volatility in the leisure and entertainment component is at play. We expect a rebound next month, but our final chart shows that the Easter effect hasn't been the only drag on the services component recently. Services inflation has been falling steadily since hitting a cyclical high of 1.5% in the middle of last year. Declining inflation in healthcare and transport services is part of the story, but the main driver probably has been the plunge in rental inflation, thanks to a change in legislation, which has reduced the cost of social housing. *Base effects from this change will be eliminated in May.*

FRENCH SERVICES CPI IS CRASHING, BUT SHOULD RECOVER SOON



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THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, April 1

• D: Final Manufacturing PMIs, Eurozone (3) 10:00 CET
The manufacturing PMI in the Eurozone probably slumped to **47.6** in March, from 49.3 in February, in line with the consensus and initial estimate. A plunge in the German index, to 44.7, was the main driver. **Consensus: 47.6**.

• D: Unemployment, Eurozone (2) 10:00 CET
We think the headline unemployment rate in the Eurozone was unchanged at **7.8%** in February. We think joblessness will fall further in this year, but it won't fall at the same rate it did last year, due to the slowdown in GDP growth. **Consensus: N/A**.

• D: Final Inflation, Eurozone (3) 10:00 CET
Headline inflation in the Eurozone probably dipped to **1.3%** in March, from 1.5% in February, dragged lower by a fall in food inflation and a lower core, which offset a further increase in energy inflation. We reckon the core rate slipped by 0.2pp to 0.8%, constrained by a big decline in services inflation, primarily due to the Easter effect in package holiday prices and airfares. That said, the **Consensus: 1.5%**.

Tuesday, April 2

• No significant data released.

Wednesday, April 3

• D: Final PMIs, Eurozone (3) 10:00 CET
We think the composite PMI in the Eurozone fell to **51.3** in March, from 51.9 in February, in line with the initial estimate. Manufacturing weakened, but services were resilient, pointing to still-decent growth domestic demand. **Consensus: 51.3**.

• D: Retail Sales, Eurozone (3) 10:00 CET
Retail sales in the euro area probably rose **0.5%** month-to-month in February, driving the year-over-year rate higher to 2.6% from a revised 2.3%. The early evidence suggests that consumers' spending rebounded in Q1, driven by strength on both goods and services consumption. **Consensus: 0.2%**.

Thursday, April 4

• D: Factory Orders, Germany (1) 08:00 CET
We reckon new orders fell **1.2%** month-to-month in February, a bit better than the 2.7% plunge in January, driving the year-over-year rate down further, by 0.8pp to -4.5%. New orders for capital and intermediate goods likely slipped. **Consensus: +0.3%**.

Friday, April 5

• D: Industrial Production, Germany (2) 08:00 CET
Industrial production probably fell **1.6%** month-to-month in February, thanks in part to a plunge in energy output due to an unusually warm month. The year-over-year probably was unchanged at -3.5%. Survey data suggest that Q1 was a write-off, but we are looking for a rebound in Q2, driven by a rebound in production of durable and capital goods. **Consensus: +0.5%**.

• D: Trade Balance, France (2) 08:45 CET
We think the French trade deficit widened to **€5.0B** in February, from €4.2B in January. The French trade deficit has improved significantly in recent months, but we reckon the trend is closer to €5.0B than €4.0B. **Consensus: €4.7B**.

PANTHEON EUROZONE FINANCIAL CONDITIONS DASHBOARD

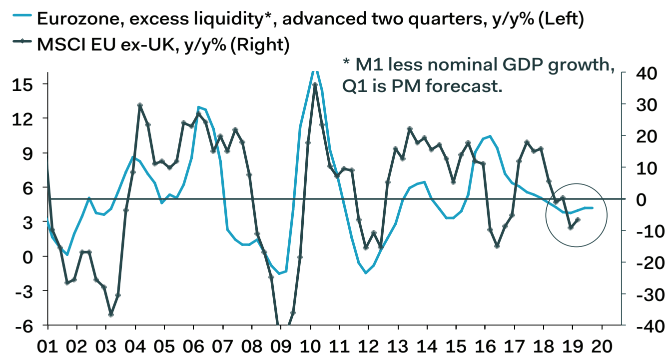
Market	Valuation*	Six month change, %	y/y, %
Eurostx 50	-0.5	-1.4	+0.3
Dax 30	-0.5	-5.8	-4.2
CAC 40	-0.2	-2.6	+3.6

* P/E ratios in standard deviations from 10y average (>1.5 = expensive, <-1.5 = cheap)

Bonds	Curve**	Six month change, bp	y/y, bp
GER (10-2)	-3.9	-46.1	-56.7
FRA (10-2)	-3.5	-31.1	-35.8
ITA (10-2)	-1.7	+14.1	+16.0

** Curve in standard deviations from its 10y average (>1.5 = historically steep, <-1.5 = historically flat)

EUROZONE EXCESS LIQUIDITY VS MSCI EU (EX UK)



EZ equities finished Q1 on a strong note alongside the other major global indices. A year-to-date return at a punchy 12%—48% annualised—suggests that investors should brace for sideways price action in coming months. Excess liquidity points to slightly higher, but still overall low, returns.

PANTHEON'S EUROZONE ECONOMIC FORECASTS (GDP: REAL GDP Q/Q%)

GDP			
Q4 18	0.2	2016 year:	1.8
Q1 19 forecast	*0.4*	*2017 year:*	*2.5*
Q2 19 forecast	*0.3*	*2018 year:*	*1.8*
Q3 19 forecast	*0.2/0.3*	*2019 year:*	*1.1*
Q4 19 forecast	*0.2/0.3*	*2020 year:*	*1.1*

CPI y/y, %		Unemployment, %	
February	1.5%	January	7.8%
March	*1.3%*	*February*	*7.8%*
April	*1.6%*	*March*	*7.8%*
May	*1.4%*	*April*	*7.8%*
June	*1.4%*	*May*	*7.7%*