



## THE WEEKLY EZ ECONOMIC MONITOR

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CLAUS VISTESEN, CHIEF EUROZONE ECONOMIST

*A jump in construction boosted German industrial output in February, probably due to mild weather.*

*Manufacturing output in Germany is running well ahead of leading indicators; expect a setback soon.*

*The French trade deficit narrowed further in February, but real net exports likely fell slightly in Q1.*

### The Plot Thickens in Germany's Manufacturing Data

Last week's manufacturing data in Germany left investors with more questions than answers. On Thursday—see [here](#)—data revealed that new orders in February fell at their fastest rate since the financial crisis, but Friday's industrial production report was completely oblivious to this story. Output increased 0.7% month-to-month in February, driving the year-over-year rate up to a four-month high of -0.4%, up from a revised -2.7% in January. That's in stark contrast to the message from the survey and new orders data that production is falling by 4-to-6% year-over-year. A 0.8 percentage point upward revision to the January headline capped the contrast with the terrible new orders data.

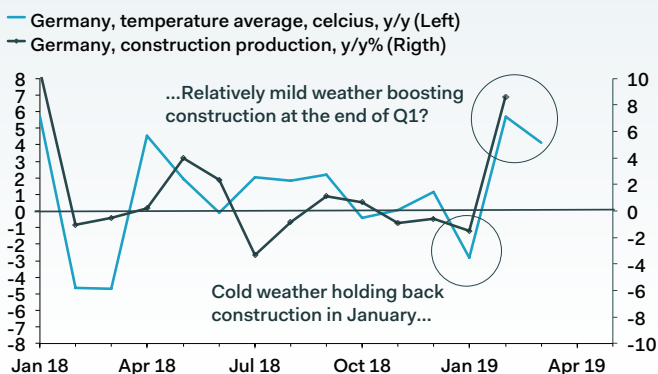
*Volatility in construction explains part of the chasm between the headline production and new*

*orders numbers.* Output in construction soared 6.8% month-to-month in February, and was the main driver of the headline, though, manufacturing output, excluding construction, fell by just 0.2%. The leap in construction almost surely is due to a relatively warm month, which followed an unusually cold January. Large temperature swings don't always drive the year-over-year rate in construction, but our first chart shows that it probably did on this occasion. This story fits the pattern of energy output, which jumped in January, but fell sharply in February. We suspect that many large construction projects were put on hold at the start of Q1, and that activity soared in February on the back of the milder weather. The available data suggests that temperatures were *relatively* high at the end of Q1, indicating that construction performed well in March too.

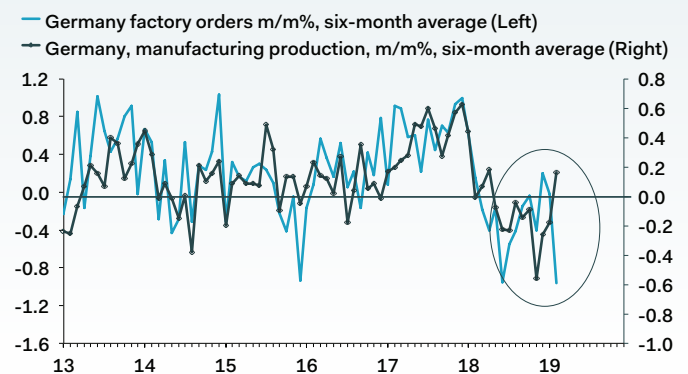
As we explained in our *Monitor* of March 26—see [here](#)—the IFO warns of slower growth in construction investment this year. But the survey *also* indicates that the slowdown won't hit until the middle of the year. For now, then, the monthly data point to a solid GDP boost from construction in Q1, though we caution that these numbers often diverge from the capex data.

Meanwhile, in manufacturing, revisions probably will reduce part of the divergence between the production numbers and the leading indicators. Our bet is that the terrible factory orders headline will be revised up a bit,

MILD WEATHER LIKELY BOOSTED GERMAN CONSTRUCTION IN Q1



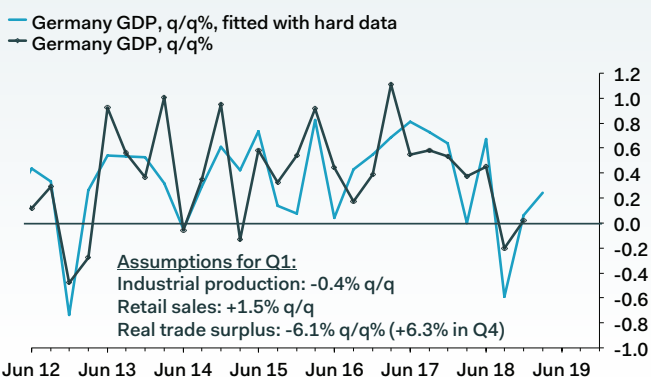
THE DIVERGENCE WILL BE SOLVED, ONE WAY OR THE OTHER



but that doesn't change the picture of steep downside risk to output growth. Our previous chart shows that it is just about plausible to argue that the recent rebound in production is a response to a rise in orders at the end of Q4, but the divergence now warns of a big setback.

We usually have a good read on Q1 GDP at this point, but the confusing manufacturing data mean that we are flying blind. *We simply don't know whether the likely correction in production was concentrated in March, or whether it has spilled over into Q2.* The evidence, such as it is, suggests that the economy performed better than implied by survey data in Q1, but some forecasters are now boasting tracking models predicting GDP growth of 0.5-to-0.6% quarter-on-quarter. *Miracles happen, but we would take such predictions with a large pinch of salt.* We still think industrial production fell in Q1, albeit at a slower rate than in Q4, but that consumers' spending accelerated, boosted by a jump in retail sales.

LOOKING GOOD, BUT IT IS NOT NECESSARILY THE FINAL WORD



Today's February trade data will add further evidence, and we think they'll reveal that exports slowed significantly, in line with the subdued IFO export expectations index. **Our assumptions currently point to quarter-on-quarter growth of 0.2-to-0.3% in Q1, thanks to strong consumers' spending, as our previous chart shows.** This forecast, however, is more unreliable than usual at this point.

**French net exports likely fell slightly in Q1**

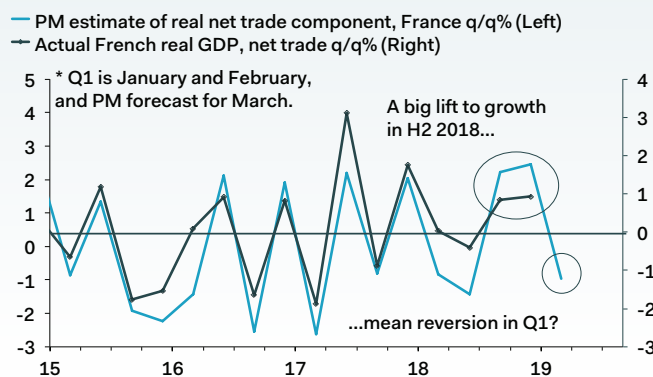
Friday's final economic report showed that the French trade deficit narrowed further in February, to €4.0B from €4.2B in January, extending the improvement since

the middle of last year. The monthly current account deteriorated, however, to -€0.8B from a revised €0.3B surplus in January, due to a reduction in the services surplus. The deficits in manufacturing and other industrial products widened, but a big fall in energy imports narrowed the deficit in hydrocarburants. This chimes with the fact that February was an unusually warm month—energy consumption and production both fell on the month—driving energy imports down.

More generally, a strong performance in exports has helped the French trade deficit in the past six-to-nine months. Export growth accelerated to 6.6% year-over-year in the first two months of the year, quicker than the average 3.9% gain in the second half of last year. Import growth, by contrast, was more modest, at about 3%.

Base effects, however, warn that net trade probably was a slight drag on GDP growth in the first quarter. **We estimate that real net exports subtracted 0.1pp from quarter-on-quarter growth in Q1, a relatively modest setback, following the cumulative 0.6pp boost in the second half of last year.** Indeed, our final chart suggests that net exports in Q3 and Q4 will be revised even higher. *Usually, falling net exports are offset by an increase in inventories.* French manufacturers accumulate stocks via imports, especially in aerospace, which means that the inventory contribution to GDP growth almost always is negatively correlated with the change in net exports. Inventories constrained GDP growth by 0.5pp in H2, so it is a fair bet to assume that they rebounded in the first quarter.

FRENCH NET EXPORTS PROBABLY FELL SLIGHTLY IN Q1



CLAUS VISTESEN

+44 191 2600 308

claus@pantheonmacro.com

Twitter: @ClausVistesen

## THIS WEEK IN BRIEF

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

### Monday, April 8

#### • D: Trade Balance, Germany (2) 08:00 CET

The headline non-seasonally adjusted trade surplus in Germany probably increased to **€16.0B** in February, from a revised €14.6B in January. We reckon that the seasonally adjusted surplus slipped to €17.6B, from €18.9B in January, driven by a large month-to-month fall in exports. **Consensus: €16.9B.**

#### • D: Sentix, Eurozone (4) 10:30 CET

We reckon the Sentix increased to **zero** in April, from -2.2 in March, driven by the pick-up in risk assets. **Consensus: -2.0.**

### Tuesday, April 9

#### • No significant data released.

### Wednesday, April 10

#### • D: Industrial Production, France (2) 08:45 CET

Industrial production in France likely fell **1.2%** month-to-month in February, driven mainly by a big decline in energy output, thanks to a relatively warm month. That said, we also think that production of durable goods fell. Our forecast is consistent with a 1.0% year-over-year decline, a big reversal from the 1.8% increase in January. **Consensus: -0.5%.**

#### • D: ECB Rate Decision, Eurozone (4) 13:45 CET

The central bank will keep its main refinancing and deposit rates unchanged, at **0.00%** and -0.4%, respectively. It will also keep in place its forward guidance that rates are set to remain unchanged until at least the end of the year. Mr. Draghi will face two key questions at the press conference. First, the president will be quizzed about the specific details for the upcoming new TLTROs, though we suspect that markets will have to wait until June for the final details. Second, Mr. Draghi will be asked to clarify his recent comments, which have been interpreted to mean ECB is preparing to introduce a tiered deposit rate. **Consensus: 0.00%.**

### Thursday, April 11

#### • D: Final Inflation, Germany (3) 08:00 CET

We think headline inflation fell to **1.3%** year-over-year in March, from 1.5% in February, in line with the initial estimate. Energy inflation increased, but this boost was overwhelmed by a big fall in inflation of services and clothing inflation, which likely pulled the core rate down to 1.0%. We reckon the HICP core rate fell to 1.1-to-1.2%. **Consensus: 1.3%.**

#### • D: Final Inflation, France (3) 08:45 CET

Headline inflation likely slipped to **1.1%** year-over-year in March, from 1.3% in February, dragged down by a slower rate of increase in services prices, and a fall in inflation of tobacco. The dip in services inflation was due to the Easter effect, which pulled down inflation of package holidays. **Consensus: 1.1%.**

### Friday, April 12

#### • D: Industrial Production, Eurozone (2) 11:00 CET

We think industrial production in the Eurozone fell **0.5%** month-to-month in February, driving the year-over-year rate up to -0.5%, from -1.4% in January. A fall in energy output likely was the primary hit, due to unusually warm weather, while production of capital goods probably rose slightly. **Consensus: -0.6%.**

## PANTHEON EUROZONE FINANCIAL CONDITIONS DASHBOARD

Market	Valuation*	Six month change, %	y/y, %
Eurostx 50	-0.4	+3.1	+1.6
Dax 30	-0.5	-0.8	-1.9
CAC 40	-0.2	+2.2	+4.2

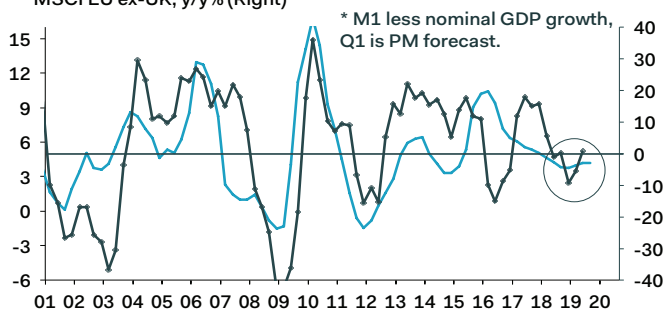
\* P/E ratios in standard deviations from 10y average (>1.5 = expensive, <-1.5 = cheap)

Bonds	Curve**	Six month change, bp	y/y, bp
GER (10-2)	-3.8	-51.2	-51.0
FRA (10-2)	-3.5	-37.0	-35.5
ITA (10-2)	-1.8	+14.9	+14.7

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

## EUROZONE EXCESS LIQUIDITY VS MSCI EU (EX UK)

— Eurozone, excess liquidity\*, advanced two quarters, y/y% (Left)  
— MSCI EU ex-UK, y/y% (Right)



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 Now points to slight downside risks to 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, %	
March	1.5%	January	7.8%
April	1.6%	February	7.8%
May	1.4%	March	7.8%
May	1.4%	April	7.8%
June	1.4%	May	7.7%