

## THE WEEKLY EZ ECONOMIC MONITOR

JULY 9, 2018  
CLAUS VISTESEN, CHIEF EUROZONE ECONOMIST

*Strong German manufacturing data add to our optimism that GDP growth accelerated in Q2, slightly.*

*Our best guess French for net exports in Q2 is an increase, at the expense of a downward revision to Q1.*

*The French trade deficit has narrowed this year as net trade with the U.S. and the U.K. has improved.*

### Evidence is Mounting that German Manufacturing did Well in Q2

Friday's industrial production data in Germany added to the manufacturing optimism following the sharp rise in new orders—see [here](#)—reported earlier in the week. Output jumped 2.6% month-to-month in May, lifting the year-over-year rate to 3.1% from a downwardly-revised 1.4% increase in April. *All sectors contributed positively to the headline.* Consumer and intermediate goods production rose 6.5% and 3.0% month-to-month respectively, while output of capital goods increased more modestly, by 0.9%. Energy production edged higher by 0.8%, mean-reverting from a 4.7% slide in April due to warm weather.

The sharp increase in construction was an additional positive surprise alongside the strong

performance in manufacturing. Production in construction rose by 3.1%, following a downwardly-revised 1.1% gain in April. A big increase in civil engineering provided the main thrust, pushing the cumulative rise in March and April up to an impressive 12.1%. The civil engineering sector was primed for a big rise in Q1 on the back of Q4's leap in new orders, but work was hampered by cold weather. *As a result, production was pushed forward into Q2, though we suspect that activity slowed in June.*

Some analysts have suggested that the sharp rise in May industrial output partly was because manufacturers front-loaded production ahead of U.S. tariffs. This is a neat narrative, but we have no hard evidence to support it. In any case, mean reversion and base effects also were key drivers of the strong headline in May. Production fell 1.4% between January and April, providing a low base for a rebound, similar to the story in the new orders data.

Our first chart shows that the rebound in manufacturing output is consistent with the recent stabilisation in the survey data. It even suggests growth could rise a bit further in coming months. We think industrial production rose 2½-to-3% year-over-year in June, consistent with a month-to-month drop

#### AFTER THE SLOWDOWN IN MANUFACTURING, STABILISATION?

- IFO business climate, manufacturing sector (Left)
- German industrial production ex-construction, y/y% (Right)



#### INDUSTRIAL PRODUCTION IN GERMANY LIKELY ACCELERATED IN Q2

- Germany, industrial production, incl construction, q/q% (Left)\*
- Germany GDP, q/q% (Right)

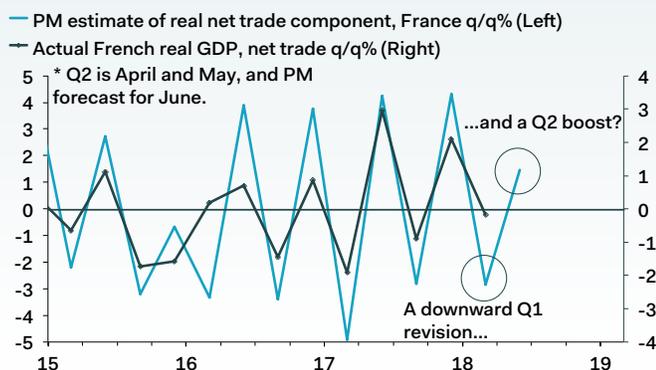


of about 1%. Adding it all together, our estimates indicate that production rose 0.6% quarter-on-quarter in Q2, accelerating from a 0.1% rise in Q1. ***This should contribute to a stronger GDP headline, at 0.4-to-0.5%, up from 0.3% in Q1, but we think year-over-year growth dipped, by 0.2pp to 2.1%.***

### What happened to French net exports in Q2?

The final economic report on Friday showed that the French trade deficit widened sharply in May, to €6.0B from a revised €5.2B in April. A 2.0% month-to-month drop in exports was the primary driver, overwhelming a trivial 0.1% decline in imports. A 15% month-to-month crash in exports of transport equipment—probably aircraft—did the main damage, reversing the 9% rise in April. Volatility is not unusual in these data, and we expect a rebound next month.

#### WHAT HAPPENED TO FRENCH NET EXPORTS IN Q2?



These data currently tell a confusing story about Q2 net exports. Our assumption for the June numbers suggests that net trade boosted growth in Q2, but this is based on mean reversion from a poor Q1 which, according to the GDP data, never happened. *In other words, our best guess is that net exports provided a decent lift to Q2 growth, at the expense of a downward revision of the Q1 numbers.*

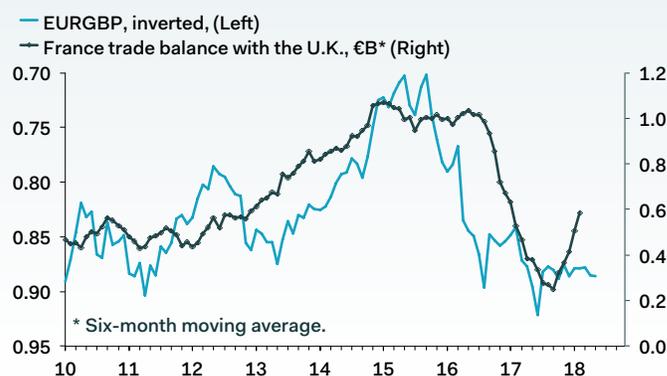
Looking beyond the Q2 story, the trend in the French trade deficit appears to have turned up slightly since the beginning of the year, primarily as the result of an improving trade advantage with the U.S. and the

U.K. The 12-month average trade balance with the U.S. has shifted into a small surplus for the first time since 2006. Admittedly, this data point is skewed by a huge jump in the March surplus to €1.8B—the largest on record by several magnitudes—driven by a one-off shipment of aircraft. That said, the upward trend is clear enough since the middle of 2016.

The French trade surplus with the U.K. also has improved significantly. Our final chart shows that the bilateral surplus with the U.K. collapsed in the wake of the Brexit referendum, in response to the sharp repricing of EURGBP. The upturn since the end of 2017 looks great, but it is not supported by a reversal in the strength of the euro relative to the pound. It probably won't go much further in the short run. Finally, the French economy's trade deficits with Germany and Asia have widened, reversing an improvement in the second half of last year.

In total, France runs a trade deficit to the tune of about 2.5% of GDP, offset by a surplus in services and primary income for a total current account deficit averaging about 0.5% of GDP since the financial crisis. The deficit improved to 0.4% of GDP in Q1, so it should widen slightly in Q2 and Q3, based on its recent trend.

#### FRENCH NET EXPORTS TO THE U.K. ARE RISING AGAIN



We will be hosting a seminar on Wednesday, July 11th at 10:30 am EST/15:30 pm London time/16:30 pm CET with the topic: "Political change and reform in the Eurozone, should investors care?" [Click here](#) to register for this event.

CLAUS VISTESEN  
claus@pantheonmacro.com

+44 191 2600 308  
Twitter: @ClausVistesens

## THIS WEEK IN BRIEF

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

### Monday, July 9

- D: Trade Balance, Germany (5) 08:00 CET**

We think the headline non-seasonally adjusted trade surplus in Germany rose to **€21.0B** in May, from a revised €20.1B in April. The seasonally adjusted trade surplus probably rose to €21.3B, from €19.5B in April. We think exports increased 1.7% month-to-month, while imports probably fell by 0.5%. Exports have slowed in the first half of the year, but we think momentum will stabilise in coming months. **Consensus: N/A.**

- D: Sentix, Eurozone (7) 10:30 CET**

The headline Sentix investor sentiment probably rebounded marginally to **10.0** in July, from 9.3 in June. The flow of economic data has improved, and equities have rebounded, slightly, from weakness in June. **Consensus: N/A.**

### Tuesday, July 10

- D: Industrial Production, France (5) 08:45 CET**

We think industrial production in France jumped **2.5%** month-to-month in May, more than reversing the 0.5% decline in April. The year-over-year likely edged slightly higher to 2.3%, from 2.1% in April. Base effects from last year—when production rose strongly—and mean reversion in energy output and oil refining probably were the key contributors. **Consensus: N/A.**

- Industrial Production, Italy (5) 10:00 CET**

Industrial output in Italy likely increased **1.2%** month-to-month, pushing the year-over-year rate higher to 3.0%, from 1.9% in April. **Consensus: 0.8%.**

- D: ZEW, Germany (7) 11:00 CET**

The headline ZEW investor expectations index probably edged up to **-12.0** in July, from -16.0 in June, in line with our expectation for a higher Sentix headline. **Consensus: -20.0.**

### Wednesday, July 11

- No significant data released.**

### Thursday, July 12

- D: Final Inflation, France (6) 08:45 CET**

We think inflation in France rose slightly to **2.1%** in June, from 2.0% in May. A sharp increase in energy inflation was the main driver, offsetting a 0.2pp fall in services inflation to 1.5%. The core rate probably fell slightly to 0.8%, from 1.0% in May, but we think it will rebound in July. **Consensus: 2.1%.**

- D: Industrial Production, Eurozone (5) 11:00 CET**

Industrial production in the Eurozone, ex-construction, likely increased **2.0%** month-to-month in May, lifting the year-over-year rate to 3.0%, from 1.9% in April. Strong gains in German consumer and intermediate goods production were the primary drivers, but output of capital goods and energy also likely rose. **Consensus: N/A.**

- D: Final Inflation, Germany (6) 14:00 CET**

Headline inflation in Germany likely dipped to **2.1%** year-over-year in June, from 2.2% in May, in line with the consensus and initial estimate. Energy and food inflation increased further, but services inflation slipped, due to the Easter effect. We suspect the headline will rise slightly further in coming months, before sliding into year-end. **Consensus: 2.1%.**

### Friday, July 13

- No significant data released.**

## PANTHEON EUROZONE FINANCIAL CONDITIONS DASHBOARD

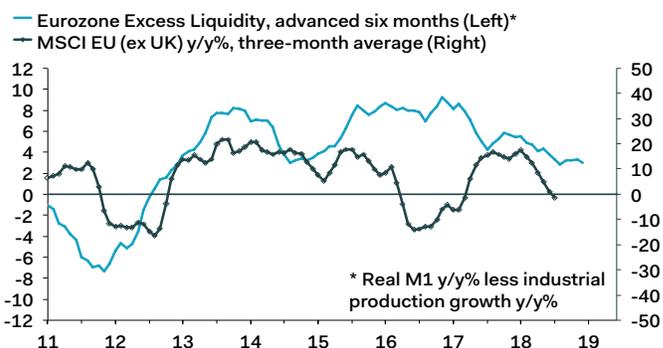
Market	Valuation*	Six month change, %	y/y, %
Eurostx 50	-0.5	-4.6	-0.7
Dax 30	-0.6	-6.4	+0.6
CAC 40	-0.3	-2.0	+4.2

\* 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)	-2.8	-9.8	-22.5
FRA (10-2)	-2.8	-14.5	-17.7
ITA (10-2)	-2.0	-45.1	-56.8

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

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



The EZ stock market is now falling year-over-year, adding weight to the gloomier story on EZ capital markets and the economy in 2018. We think the headline MSCI EU ex-UK will be volatile over the summer, before rising in Q4.

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

GDP			
Q3 17	0.7	2016 year:	1.8
Q4 17	0.7	2017 year:	2.5
Q1 18 (2nd E)	0.4	2018 year:	2.0
Q2 18 forecast	0.4	2019 year:	1.7
Q3 18 forecast	0.4	2020 year:	1.4

CPI y/y, %		Unemployment, %	
June	2.0%	May	8.4%
July	2.2%	June	8.4%
August	2.2%	July	8.4%
September	2.0%	August	8.3%
October	1.9%	September	8.3%