Retail sales and industrial production data point to sluggish Q4 GDP growth in the Eurozone...

...But a likely rebound in construction investment could offer much needed support.

French inflation is slowly rising, but it lags, and doesn't tell us where the economy is going.

A Downbeat Outlook for Q4 GDP Data in the Eurozone

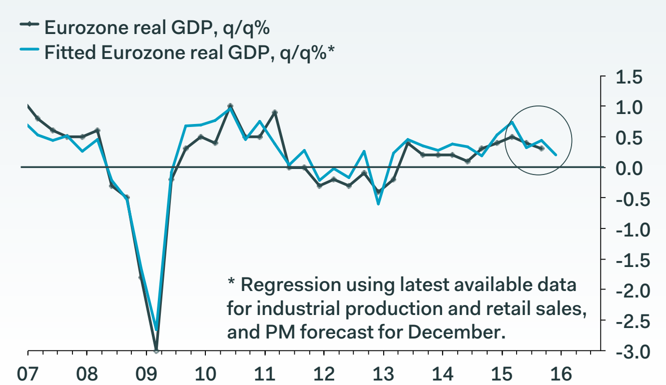
EZ survey data were solid in the fourth quarter, pointing to robust GDP growth, but numbers from the real economy have so far not lived up to the rosy expectations. Data yesterday showed that industrial production fell 0.7% month-to-month in November, pushing the year-over-year rate down to 1.1% from a revised 2.0% in October. Italian data today likely will force marginal revisions to the headline next month, but they are unlikely to change the big picture. The key hit to production came from a large monthly fall in energy, due to an unusually warm November in France and Spain. *Swings in these data* usually *mean-revert the following month, but December was also very warm, so we can't be sure this will be the case.*

We are encouraged, though, by the higher manufacturing PMI in Q4, pointing to production growing 1.5%-to-2.0% year-over-year, admirable given the pronounced weakness in global production due to headwinds from slowing GDP growth in China. That said, the poor data increases downside risks for the Q4 GDP outlook. *We think both industrial output and retail sales rebounded in December, but even with our assumptions, the forecast is for a weak 0.2% quarter-on-quarter increase.*

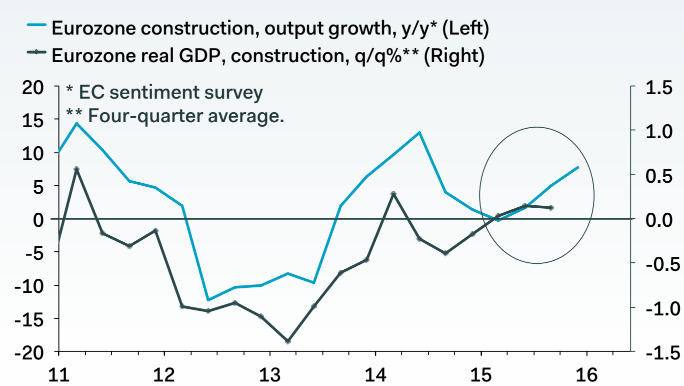
This downbeat outlook is a result of poor retail sales data pointing to weak consumers' spending *without* offsetting support from investment. ***We have warned that GDP data could disappoint if household consumption slowed, and we suspect this was indeed the story in Q4.*** Preliminary forecasts also offer little hope for a rebound in net trade, which likely was depressed again by lower import prices—due to the plunge in oil prices—lifting the *real* value of imports.

Investment in construction, however, is a dark horse and should lift GDP growth. Construction is very volatile on a quarterly basis, and tends to be heavily revised, but recent survey data suggest that output rose in the fourth quarter. Capital expenditures in

CORE DOMESTIC DEMAND DATA POINT TO Q4 GDP SLOWDOWN...



...BUT CONSTRUCTION INVESTMENT IS A DARK HORSE



the construction sector are 50% of total investment in the euro area, and a jump in investment could lift GDP growth significantly. Public spending probably also helped GDP growth, due to increasing demands on governments to house and process the inflow of migrants. Tax revenue in Germany also rose more than expected last year, leaving room for a more sustained stimulus this year due to carry-over effects.

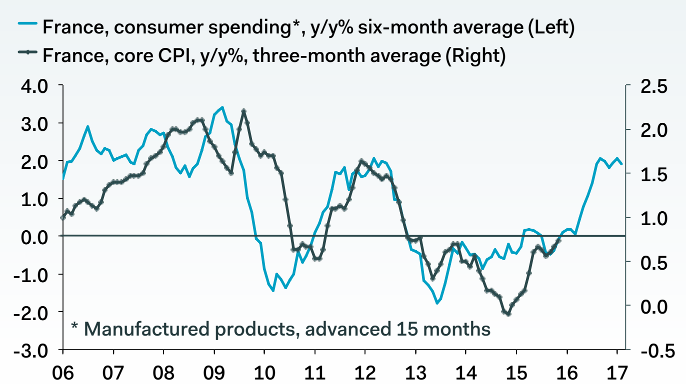
Finally, a Q4 slowdown in GDP growth is unlikely to signal a sustainable downshift in activity. ***Survey data and leading indicators—real M1—point to underlying EZ GDP growth of 0.3%-to-0.5% quarter-on-quarter, and we won't change our story unless that message changes.*** But we are on alert for a negative surprise in today's preliminary 2015 estimate for German GDP, which is unlikely to come in at the consensus expectation of 1.7%. *We think 1.4%-to-1.5% is more likely.*

Slow but steady recovery in French inflation

French CPI data yesterday gave respite to investors worrying over a relapse into deflation. Inflation rose to 0.2% year-over-year in December from 0.0% in November, mainly lifted by the energy component. Energy price inflation rose to -4.7% year-over-year from -6.0% in November, offsetting a fall in food inflation to 0.6% from 0.8% in November. An unusually warm December increased the supply of domestic fresh food, pushing inflation lower. This increases uncertainty for these data in the first quarter, but we think mean-reversion will push food inflation down further in coming months, following its sharp increase since the summer. Core inflation rose to 0.8% year-over-year from 0.7% in November, boosted by higher inflation for manufactured goods, offsetting a marginal decline in services due to lower inflation for rents.

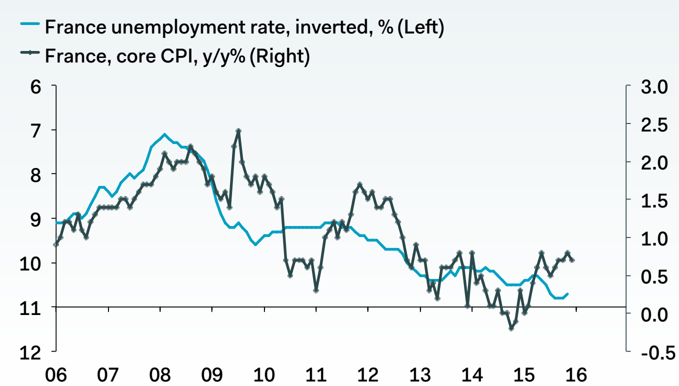
Core inflation is a very lagging indicator in France, almost to the extent that its trend is completely disconnected from other economic data and events in financial markets. During the financial crisis, the year-over-rate rose almost uninterruptedly throughout 2008, and eventually peaked in the summer of 2009. It troughed in the first quarter of 2011, almost two years *after* the economy and financial market had bottomed. Inflation matters to the ECB, however, and we think the recent recovery in French core inflation will continue this year, consistent with the increase in consumers' spending and GDP growth since 2012. High unemployment, however, means that inflation is unlikely to surge, and we doubt inflation pressures in France will be of much concern to the central bank.

FRENCH CORE INFLATION WILL INCREASE FURTHER THIS YEAR...



* Manufactured products, advanced 15 months

...BUT HIGH UNEMPLOYMENT MEANS THAT SLOWLY DOES IT



Eurozone conference call, Wednesday, January 20th, at 10.30am Eastern US time/15.30 London/16.30 CET.

The headline for the presentation is: "Falling oil prices and risk asset turmoil could force the ECB's hand." To access the call, please dial in at 10:25 am Eastern to +1 630-395-0126 and the passcode is "Pantheon".

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THIS WEEK IN BRIEF

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

Monday, January 11

- **D: Sentix Investor Survey, Eurozone (1) 10:30 CET**

The headline Sentix index fell to **9.6** in January from 15.8 in December, depressed by increased volatility in equity markets. Confidence should rebound later in the first quarter, though, on the back of easy monetary policy and a stronger economy.

Tuesday, January 12

- **No significant data released.**

Wednesday, January 13

- **D: Inflation, France (12) 08:45 CET**

Inflation in France rose to **0.2%** year-over-year in December, from 0.0% in November. Higher energy price inflation—due to base effect in oil prices—and strong inflation for manufactured goods were the key drivers.

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

Industrial output fell **0.7%** month-to-month in November, pushing the year-over-year rate down to 1.1% from a revised 2.0% in October. Energy output was the main drag, especially in France and Spain.

Thursday, January 14

- **D: Full-year GDP estimate, Germany (Q4) 10:00 CET**

We think the statistical office will estimate full-year GDP growth at **1.4%** year-over-year in 2015, down from 1.6% in 2014, due mainly to disappointing data in the fourth quarter. The consensus looks too upbeat to us. **Consensus: 1.7%.**

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

Industrial production likely fell **0.2%** month-to-month in November, pushing the year-over-year rate down slightly to 2.0% from 2.8% in October. **Consensus: 0.2%.**

- **D: ECB Minutes, December Meeting (12) 13:30 CET**

This document will be parsed closely for signs of hawkish dissent following the "disappointing" policy package last month. The focus will particularly be on the extent to which the doves were rebuffed in terms of their inclination to increase the pace of QE purchases.

Friday, January 15

- **D: Car Registrations, EU27 (12) 08:00 CET**

Growth in car registrations likely slowed to **5.0%** year-over-year in December from 13.7% in November. Surging growth rates in the periphery—partly due to base effects lifting the year-over-year rate—remain a key driver. **Consensus: N/A.**

- **D: Trade Balance, Eurozone (11) 11:00 CET**

The Eurozone's trade surplus with non-euro area economies probably rose marginally to **€21.3B** in November from €19.9B in October. Exports to the U.S. and the U.K. are the key drivers of the solid surplus, with exports to China and other emerging markets a drag. **Consensus: €20.5B.**

PANTHEON EUROZONE FINANCIALS CONDITIONS DASHBOARD

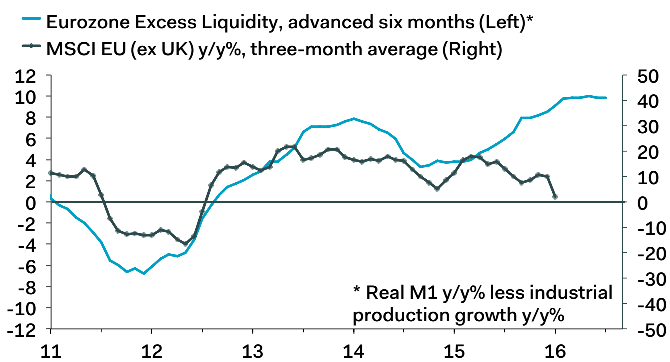
Market	Valuation*	Six month change, %	y/y, %
Eurostx 50	0.6	-12.6	1.3
Dax 30	0.3	-11.5	3.8
CAC 40	0.4	-10.4	5.2

* 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)	-1.9	-18.8	30.9
FRA (10-2)	-1.5	-17.8	40.5
ITA (10-2)	-1.3	-32.4	16.2

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

EUROZONE EXCESS LIQUIDITY VS MSCI EU (EX UK)



Equities have had a torrid start to the year, but macroeconomic leading indicators suggest that investors be brave and buy the dip. The outlook for Q1 is solid.

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

GDP			
Q3 2015	0.3	2014 year:	0.9
Q4-15 forecast	0.4	*2015 year:*	*1.5*
Q1-16 forecast	*0.3*	*2016 year:*	*1.6*
Q2-16 forecast	0.5	*2017 year:*	*1.0*
Q3-16 forecast	0.4		

CPI y/y, %		Unemployment, %	
November	0.2%	October	10.7%
December	*0.4%*	*November*	*10.7%*
January	*0.7%*	*December*	*10.6%*
February	*1.0%*	*January*	*10.6%*
March	*1.1%*	*February*	*10.5%*