Eurozone Economic Update

AIB Treasury Economic Research Unit

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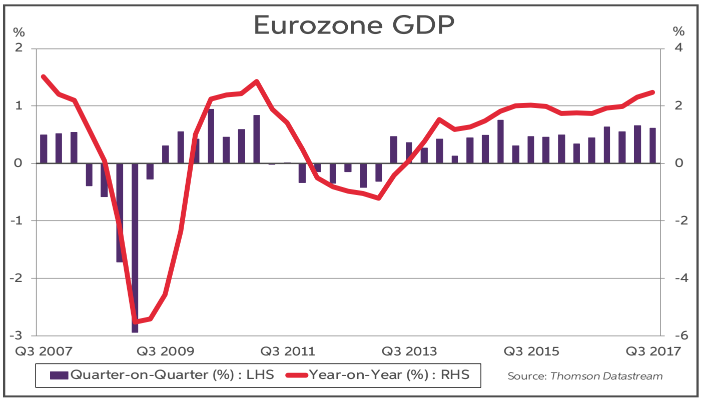
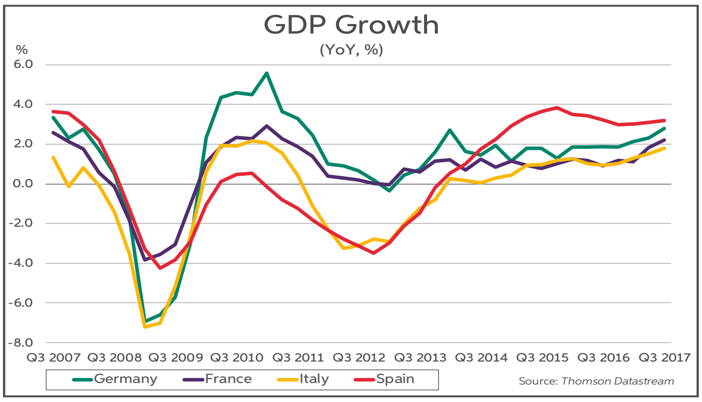
Eurozone moves to the top of the class

It is very ironic that just as the UK is preparing to leave the EU, the Eurozone has become the fastest growing economic region in the developed world. Data published last week showed another strong rise in Eurozone GDP of 0.6% for the third quarter. GDP growth in year-on-year terms was 2.5%, ahead of the US, UK and Japan which posted gains of 2.3%, 1.5% and 1.7%, respectively.



The argument of those in favour of Brexit about the need for the UK to leave the slow-growing EU economy to forge links with strongly growing countries now sounds rather hollow. It is true, though, that the recovery in the Eurozone is lagging elsewhere, as evidenced by the continuing high level of unemployment. The number of jobless, though, is in steady decline, with the unemployment rate now down below 9% from a peak level of over 12%.

The fact that the recovery in the Eurozone is less advanced than elsewhere suggests that it has the capacity to continue growing strongly for quite some time. Monetary conditions in the Eurozone are expected to remain very accommodative over the next few years, which will also be supportive of growth. Three month interest rates in the Eurozone are expected to remain negative until the end of 2019 and not rise to 1% until 2023.



It is also encouraging that the upswing in the Eurozone is broad-based, with all the major economies now growing strongly. This includes France, Italy and Spain, which recorded annual growth rates of 2.2%, 1.8%, and 3.1%, respectively in the third quarter. German GDP rose by 2.8%, with the Netherlands seeing growth of 3.3%.

The absence of significant imbalances also suggests that strong growth can continue. Inflation is subdued, with the EU Commission forecasting that it will remain at around 1.5% over the next couple of years. The Eurozone is also expected to continue running a large surplus on its balance of payments of around 3% of GDP, with most countries in surplus.

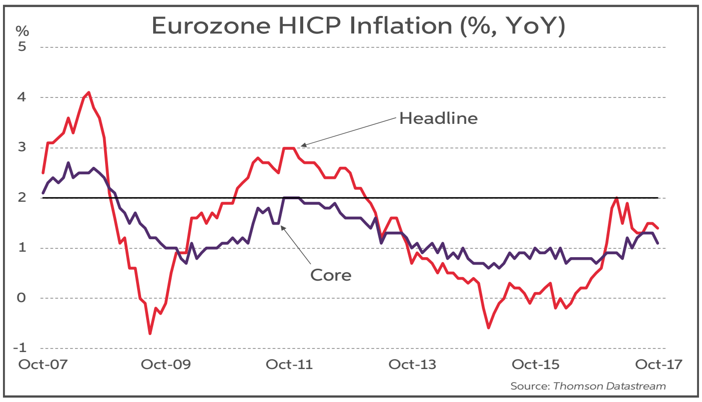
Meanwhile, budget deficits in the Eurozone now average just 1% of GDP, while the general government debt ratio has been in decline since 2014. Overall, the public finances and balance of payments are in much better shape in the Eurozone than the US, UK or Japan.

Oliver Mangan
Chief Economist
oliver.n.mangan@aib.ie

John Fahey
Senior Economist
john.j.fahey@aib.ie

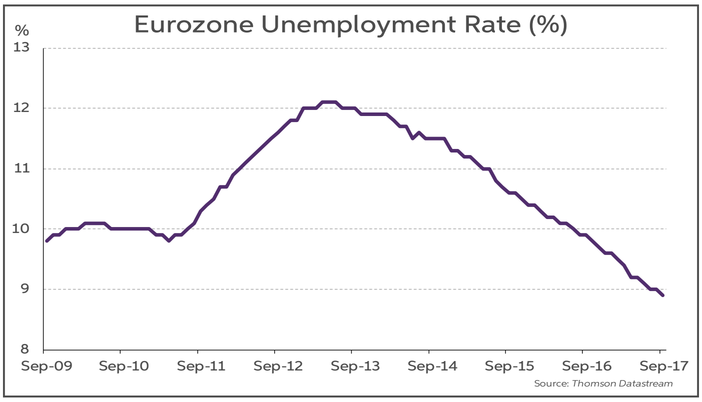
Dara Turnbull
Economist
dara.c.turnbull@aib.ie

The external environment is also favourable, with the global economy strengthening and growing at its strongest rate in seven years. The pick-up is evident in both advanced and emerging economies and has been accompanied by a marked improvement in global trade.



The euro fell sharply in 2014-15 and while it has recovered ground since then, it remains at quite competitive levels against most currencies, with the notable exception of sterling. Thus, the Eurozone is well placed to take advantage of improving global demand and trade.

The Eurozone still faces problems, including marked regional disparities in unemployment as well as very high youth unemployment in some countries, slow productivity growth, weak wage growth and a continuing aversion to structural reforms that would raise growth and boost living standards. The banking and financial system is also still undergoing repair from the damage done by the crash at the end of the last decade.



Nonetheless, the economic prospects in the Eurozone look brighter now than at any time in the past decade. This is good news for Ireland as it faces all the uncertainty brought about by Brexit. The Eurozone is by far our most important external market, taking over 33% of Irish exports. Ireland needs to forge even closer links in the years ahead with other Eurozone economies, especially given we share a common currency.

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