PICTET 1805

Flash Note

Europe chart of the week – #Euroboom

Laggards are catching up with the euro area recovery

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The current leg of the euro area recovery is about both quantitative and qualitative improvement in the economic outlook.

Trend GDP growth in France and Italy has risen to 2.2% and 1.8%, respectively, on an annualised basis. Those countries are catching up with the strongest member states, more than compensating for the moderate growth slowdown we forecast in Germany and Spain.

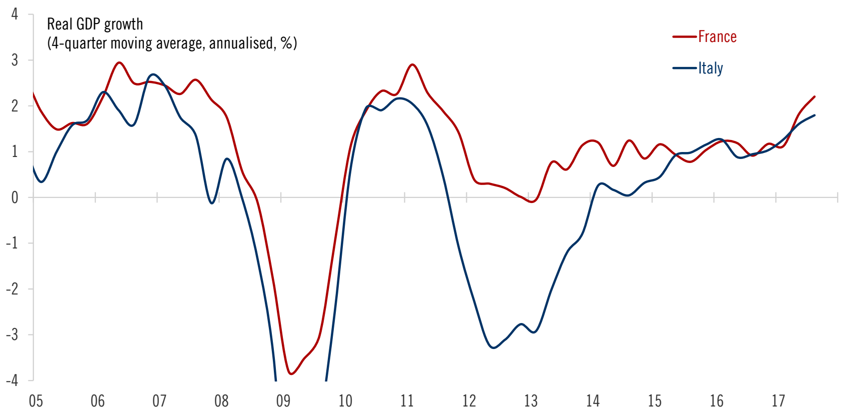
Companies have used this increased visibility about the economic outlook to boost employment and investment spending. We see large positive effects on public finances too. Last but not least, a faster closing of the output gap should eventually translate into stronger wage growth and inflation.

The way we see it, '**Euroboom**' – a trending topic on Twitter this year – is about both **quantitative and qualitative improvement** in the euro area macro outlook. The latest leg of this robust and broad-based recovery has been increasingly driven by laggard countries catching up with the rest of the pack. **Real GDP growth in France and Italy has risen to 2.2% and 1.8%, respectively**, on an annualised basis over the past 4 quarters, with business surveys, including this week's Italian PMI, close to cyclical highs.

This acceleration in the pace of economic expansion is probably being driven by a combination of factors. There is growing evidence of **rising demand from other euro area member states,** which should be after all the key benefit of being a member of an integrated, however imperfect, monetary union and single market. Some structural **reforms** may have played a role, including Italy's Jobs Act or the prospects of **tax cuts**, although it may be too early to tell in the French case. More fundamentally, it is the removal of systemic constraints on corporate investment and animal spirits, in our view, which led to this catch-up. Political risks remain, but they are no longer expected to result in the kind of existential crisis facing the region in previous years.

These developments have critical implications: 1) a business cycle resilient to external shocks (e.g. a stronger EUR) providing visibility to companies; 2) self-sustained job creation; 3) stronger fiscal revenues providing some budget flexibility while lowering the required primary balance to stabilise public debt; 4) a faster closing of the output gap, eventually resulting in higher wage growth and inflation. No wonder the ECB feels more confident.

Chart: trend GDP growth in France and Italy shifting up a gear



Source: Pictet WM – AA&MR, Eurostat, Insee, Istat

AUTHOR

Frederik DUCROZET
fducrozet@pictet.com
+41 58 323 4582

Pictet Group
Route des Acacias 60
CH - 1211 Geneva 73
www.pictet.com