FISHER INVESTMENTS®

Economics

Does Slower Eurozone Growth Mean Recession Looms?

Recent data on eurozone growth is adding to fears, but we don't think these match reality.

By Fisher Investments Editorial Staff, 11/07/2018

Eurozone GDP grew 0.8% annualized in Q3—the slowest growth of its five-and-a-half-year expansion—sparking recession (https://www.theguardian.com/business/live/2018/oct/30/eurozone-gdp-french-italy-growth-economy-markets-business-live) worries and more jitters for eurozone stocks.[i] October's composite purchasing managers' indexes (PMIs), which hit their lowest level in two-plus years in the eurozone and showed contraction in Italy, added more fuel to the fire. However, we think extrapolating a recession from two data points is a mite hasty. To us, all of this speculation speaks to overly dour sentiment toward the eurozone, rather than presenting good reasons to be pessimistic about eurozone stocks. Stocks typically look forward, not backward, and have likely already moved on from the summer slowdown.

First off, we think it is important to note eurozone data weren't weak across the board. Of the handful of countries reporting thus far, France accelerated. So did Spain and Austria. Italy slowed to 0.0% q/q (0.1% annualized), so most fears centered there, presuming falling industrial production meant tariffs were starting to bite.[ii] Similar fears surround Germany, which hasn't reported GDP yet but is widely expected to show slowing growth. To us, it seems like a stretch to presume recession looms and eurozone stocks will sink further as they price it in. There are plenty of potential benign reasons for slower GDP, including things like strong imports. Imports represent domestic demand—a positive—but GDP math counts them as negative. Or maybe private inventories fell as strong demand surprised suppliers. Another potentially positive explanation could be weaker government spending masking stronger private sector growth. Yes, there could be negative reasons too—it is entirely possible domestic demand sagged a bit. Our point is simply that it is too soon to know either way. Without knowing details on the various components (consumer spending, private investment, trade, government spending), it is impossible to draw sweeping conclusions.

While GDP data garners lots of attention, it doesn't move one-to-one with stocks. The economy isn't the stock market. A share of stock represents a slice of a company's future earnings. But economies represent all commerce—public and private companies, self-employed folks, government and investment. GDP is an imperfect attempt at tallying that. In addition, the data are inherently backward looking. Releases cover old news, reporting details of economic activity in the previous quarter. But one quarter's GDP doesn't predict the next. Now people are latching onto October PMIs as evidence of further weakness, but PMIs don't measure growth's magnitude. They tell you what percentage of firms grew, but not by how much. About the only takeaway is that with the eurozone composite PMI presently at 53, more firms are growing than not—and, while narrower than previously, by a still-comfortable margin.

Moreover, rip-roaring GDP growth isn't necessary for stocks to do well. People link eurozone stocks' great 2017 with strong GDP growth. But 2017's 2.4% GDP growth was actually only a small uptick from 2016's 1.9%.[iii] Stocks did well because things went better than expected, politically and economically. The European Commission expected (http://europa.eu/rapid/press-release_IP-16-3611_en.htm) growth of just 1.6% as 2016 ended. The ECB predicted (https://www.ecb.europa.eu/press/key/date/2017/html/sp170315.en.html) growth between 1.6% and 1.8%. The OECD estimated (https://www.oecd.org/eco/outlook/economic-forecast-summary-euro-area-oecd-economic-outlook-june-2017.pdf) growth of 1.75%. Overall, most foresaw a slowdown, setting a low bar for reality to exceed expectations. Meanwhile, euroskeptic politicians either weren't successful or largely moderated from more extreme positions. In the Netherlands' March elections, voters picked incumbent Prime Minister Mark Rutte over the populist euroskeptic Geert Wilders. France's Marine LePen's presidential bid flamed out. German voters re-upped the centrist grand coalition headed by Angela Merkel. Italy aside, investors' fears of populists taking the eurozone by storm didn't come to fruition, providing a tailwind for markets.

The same negative sentiment is prevalent now. Pundits fret about issues like the ECB ending its quantitative easing (QE) program and trade tensions, but we believe these fears are blinding folks to a better-than-appreciated reality. We already have evidence QE ending shouldn't bring disaster. The ECB started reducing QE in April 2017, reducing bond purchases from €80 billion/month to €60 billion, and the economy accelerated. When the UK ended QE in November 2012, its economy was coming off a weak stretch. But growth firmed up in 2013. Similarly, the US economy did fine as the Fed tapered and eventually ended QE in 2014. As for trade, this year's new tariffs and threats amount to around 0.3% of global GDP, based on recent IMF estimates. We don't deny some eurozone exporters are feeling somewhat of a pinch, but the eurozone economy is 73% services, which are insulated from tariffs.[iv] Growth in services can pull the rest along.

[i] (EditorPage.aspx?da=core&id=%7BEE55E9A9-2C92-43BF-93E6-82D17DDCBDD3%7D&ed=FIELD704389176&vs&la=en-US&fld=%7B431F1ABC-49AA-4C12-B6C9-0F7E45344904%7D&so&di=0&hdl=H704389237&mo&pe=0&fbd=1#_ednref1) Source: Eurostat, as of 11/6/2018. Q3 2018 seasonally adjusted real GDP growth, annualized.

[ii] (EditorPage.aspx?da=core&id=%7BEE55E9A9-2C92-43BF-93E6-82D17DDCBDD3%7D&ed=FIELD704389176&vs&la=en-US&fld=%7B431F1ABC-49AA-4C12-B6C9-0F7E45344904%7D&so&di=0&hdl=H704389237&mo&pe=0&fbd=1#_ednref2) Source: Istat, as of 11/6/2018. Q3 2018 seasonally adjusted real GDP growth, q/q and annualized.

[iii] (EditorPage.aspx?da=core&id=%7BEE55E9A9-2C92-43BF-93E6-82D17DDCBDD3%7D&ed=FIELD704389176&vs&la=en-US&fld=%7B431F1ABC-49AA-4C12-B6C9-0F7E45344904%7D&so&di=0&hdl=H704389237&mo&pe=0&fbd=1#_ednref3) Source: Eurostat, as of 11/6/2018. Real GDP growth, 2016 and 2017.

[iv] (EditorPage.aspx?da=core&id=%7BEE55E9A9-2C92-43BF-93E6-82D17DDCBDD3%7D&ed=FIELD704389176&vs&la=en-US&fld=%7B431F1ABC-49AA-4C12-B6C9-0F7E45344904%7D&so&di=0&hdl=H704389237&mo&pe=0&fbd=1#_ednref4) Source: Eurostat, as of 11/6/2018. 2017 GDP gross value added by industry.

If you would like to contact the editors responsible for this article, please click here (/en-us/marketminder/contact).

**The content contained in this article represents only the opinions and viewpoints of the Fisher Investments editorial staff.*