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Eurozone GDP: Germany wins the 100 meter dash; PIGS never left the starting blocks

ECB President Jean-Claude Trichet must be looking disapprovingly in the direction of Germany today. Without the fireworks produced by the largest member of the Eurozone progress in the second quarter would be weak, but at least homogenous. Instead the ECB is left with a divided Eurozone where interest rate needs vary greatly – at least when looking through the greasy glasses of a Keynesian central banker.

The Eurozone economy grew a solid 1.7% year-on-year, up a full percent quarter-on-quarter. Germany's impressive 2.2% quarter-on-quarter growth rate translates into a stunning 9.1% on an annualised basis. The recovery is driven by a pick-up in global trade and inventory adjustments while consumption both public and private remains insipid. Governments have been forced to introduce austerity measures in response to the sovereign debt crisis earlier this year and this will weigh on consumption for a long time.

The report is an improvement on the last one, but does contain some pitfalls. The 1.7% growth rate – which is of course only solid compared to the recent past – is papering over a large gulf between the north and south of the Eurozone. The industrious Germans achieved China-like growth of more than 9% quarter-on-quarter on an annual basis. Without them the quarterly growth would have been a paltry 0.3%; or 0.9% from a year ago. Not even a single percent of additional output have the other members managed to produce since the trough in June 2009. Even worse, the PIGS countries still cannot get any traction in the slippery mud and their output only edged up 0.3% from twelve months ago.

The Eurozone members should celebrate the growth they are experiencing now because it is not going to last forever. Unless we see another serious decline in the Euro, the contribution from the drop in the first half of the year will fade together with inventory adjustments. This will leave the Eurozone economy with overleveraged consumers likely to keep their money in their pockets, and governments with a newfound sense of fiscal responsibility. GDP growth will remain low for an extended period of time, to use a popular phrase.

We are not going to dispute the grandeur of a 9.1% annualized GDP growth rate, but Germany too will face several headwinds in the second half of 2010 and beyond. First, Germany is the second-largest exporter in the world and is therefore dependent on the wellbeing of its major trading partners. We expect many of them, including the rest of the Eurozone and the US, to grow at a slow rate. Second, Germany will undergo austerity measures just like the other members to the south in an attempt to reduce its public debt-to-GDP ratio. Third, a significant part of the 9% print was inventory adjustments, which are purely transitory and will only offer a few quarters worth of GDP growth.

Overall, 1.7% sure beats 0.6%, but several obstacles remain including the large divide between the southern and northern part of the Eurozone. Germany may be a charging locomotive, but the passenger wagons have been left at the station.

General

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