Developed Europe: Growth Picks Up; Political Uncertainty In Germany, Spain

KEY TAKEAWAY

GDP in the single-currency Euro-zone, the largest and most significant part of Developed Europe, expanded 0.6% in the third quarter, matching the growth rate clocked in the second quarter.

Germany: Germany's seasonally adjusted GDP climbed 0.8% between the second quarter and the third, outpacing the 0.6% quarterly expansion recorded at the end of June.

Following an excellent second quarter, the Developed Europe economy showed further improvement during the August-October review period. GDP in the single-currency Euro-zone, the largest and most significant part of Developed Europe, expanded 0.6% in the third quarter, matching the growth rate clocked in the second quarter. Year-on-year, the Euro-zone grew 2.5%, the fastest since early 2011. Not surprisingly, the European Commission has declared that 2017 will most likely see the Euro-zone post its best annual performance in a decade. What's more, in October, the International Monetary Fund (IMF) raised its outlook for global growth citing the Euro-zone as the main reason for the upgrade.

Indeed, the Euro-zone appears to have garnered strong momentum now as its primary growth engine, Germany, continues to hum along and member economies that have been laggards until recently, such as Italy, seem to have turned the corner. During the third quarter, Germany's GDP growth accelerated on the back of robust exports and investments while Italy remains on track to register its best yearly performance since 2010.

The Euro-zone has one persistent concern though. The currency area's inflation growth remains largely inconsistent, which means that the efforts of the European Central Bank (ECB) to ensure a sustained price recovery have not succeeded so far. In October, the Euro-zone's annual price growth declined to 1.4% from 1.5% in September. What's worse, core inflation, which excludes volatile food and energy prices, fell below 1% for the first time in five months.

Given this situation, the ECB has adopted a conservative approach toward withdrawing its bond-buying stimulus program, despite the robust economic conditions. At its most recent policy meeting, the central bank decided to halve bond purchases beginning in January and to not raise interest rates until 2019.

GERMANY: ECONOMY ROBUST BUT POLITICAL UNCERTAINTY MARS SHORT-TERM OUTLOOK

The latest review period saw Germany retaining its pre-eminent position as the main growth driver of Developed Europe. But, political uncertainty following federal elections in September marred the optimism surrounding the country. Germany's seasonally adjusted GDP climbed 0.8% between the second quarter and the third, outpacing the 0.6% quarterly expansion recorded at the end of June. The growth acceleration was chiefly driven by strong exports and business investments.

Overseas sales jumped 1.7% from the second quarter, accounting for half of the overall GDP growth between July and September. This data is significant since it marks the likely return of exports as the key driver of the German economy, which has relied on private consumption, state spending and a

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The U.K.: At the end of September, the U.K. economy expanded 0.4% from the second quarter and 1.5% from the same period a year ago. The quarterly growth rate exceeded expectations.

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booming construction sector in recent quarters. Among other indicators, investments in machinery and equipment climbed 1.5% in the third quarter, but construction investment fell 0.4%. Household spending too slipped 0.1% and government spending stayed flat.

Notably, a comparison between the third quarter and the second reveals an interesting contrast. In the second quarter, both household spending and construction investment contributed significantly to GDP growth while net trade had a negative impact on growth. The situation appears to have reversed in the third quarter when exports drove the economy while household spending and construction investment faltered.

Nonetheless, this is unlikely to develop into a trend as the outlook for household spending remains positive amid the surge in business investment. As investments pick up speed, hiring is expected to gain momentum, which should boost consumption. In fact, given the current resurgence in exports, the German economy seems set to benefit from both domestic consumption and global trade in the coming quarters.

Be that as it may, there is a bit of trouble for Germany in the near term. After the federal elections in September yielded a fractured mandate, Chancellor Angela Merkel has been struggling to bring together rival factions to form a coalition government. So, until a new government is cobbled together, or a second vote is held for a fresh mandate, political stability may elude Germany.

THE U.K.: MODEST GROWTH DESPITE BREXIT FALLOUT

At the end of September, the U.K. economy expanded 0.4% from the second quarter and 1.5% from the same period a year ago. The quarterly growth rate exceeded expectations as most analysts had projected a slower pace of expansion in view of the Brexit-related uncertainties prevailing in the country. The services, manufacturing and auto sectors contributed significantly to the third-quarter performance. However, growth was not broad-based. For example, while construction output declined 0.7% between the second quarter and the third, industrial production went up 1.0%. On the whole, most third quarter data showed that Brexit-related uncertainties took a toll on the economy.

The services sector, which accounts for two-thirds of GDP in the U.K., expanded at a modest pace in September, with sales growth decelerating to the lowest rate since August 2016. Notably, consumer spending was chiefly responsible for the moderate sales growth while new orders from businesses actually declined, signaling that business confidence has been subdued lately. Separate surveys of the U.K. manufacturing and construction sectors also showed a mixed picture in September.

In the coming quarters too, the outlook for the British economy appears to be muted. The U.K.'s Brexit negotiations with the European Union have started, but the discussions remain mired in complexity, without any significant headway. So, business confidence is expected to stay subdued for a while now. Unfortunately, consumer confidence in the country has also been weakening since the middle of 2017 and the recent interest hike rate by the Bank of England is likely to exacerbate the problem.

FRANCE: LABOR REFORMS UNVEILED AMID CONTINUED STRENGTH IN THE ECONOMY

France reported a mixed set of data in the latest review period. The economy grew 0.5% between July and September, slightly underperforming the 0.6% growth clocked in the second quarter. However, year-on-year, GDP climbed 2.2%, recording its fastest pace of expansion since the second quarter of 2011. What's more, the third quarter marked four consecutive quarters of solid growth for France.

Just as in the broader economy, news from the French labor market was also mixed. Between the second quarter and the third, the country's unemployment rate rose from 9.5% to 9.7%, indicating that recent optimism notwithstanding, economic conditions have not improved sufficiently to bring down unemployment on a sustained basis. The good news though is that in late September French President Emmanuel Macron kick started his reforms program by signing five decrees overhauling labor norms.

The new rules, which are expected to take effect by the beginning of 2018, give businesses greater flexibility to hire and fire employees. They also place a ceiling on payouts for dismissals that are deemed to be unfair. Notably, these are only the first stage of labor reforms and President Macron has indicated that the next phase of changes is in the pipeline.

Moving forward, it seems unclear whether France will be able to sustain its current growth momentum in the short term. In October, a measure of confidence in the country's manufacturing sector reached its highest level in almost a decade but consumer confidence, which was the key driver of third-quarter growth, slipped 1.9% from the previous three months. The French government has projected 1.7% growth in 2017, which would be the country's strongest performance in a calendar year since 2011.

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Italy: Between the second quarter and the third, the Italian economy expanded 0.5%, outdoing the 0.4% growth recorded from April to June.

Spain: Spain's GDP jumped 0.8% in the third quarter, meeting estimates but slightly underperforming the 0.9% growth recorded in the second quarter.

ITALY: IMPROVED DATA POINT TO STRENGTHENING RECOVERY

At the end of the second quarter, Italy, the Euro-zone's perennial laggard, surprised commentators with a solid set of statistics. Since then, the country has reported even better economic data, providing more evidence of its strengthening recovery. Between the second quarter and the third, the Italian economy expanded 0.5%, outdoing the 0.4% growth recorded from April to June. With this, Italy also registered its eleventh consecutive quarter of growth.

What's more, in the eight months from January to August, the country's export volumes climbed 2.8% from the same period last year, which likely means Italian businesses that are globally competitive are doing well now. Taking into account these encouraging developments, Standard & Poor's recently raised Italy's sovereign credit rating for the first time in 35 years. The agency said growing investment and employment had improved Italy's outlook.

On a cautionary note though, it is important to be mindful that Italy is still not completely out of the woods. The country is yet to deal with most of its structural weaknesses, including red tape, corruption, high public debt, banking sector problems and low labor productivity. Moreover, its unemployment rate remains in double digits and among the highest in the European Union. So, how long the country can sustain its current revival is anybody's guess. Nevertheless, the most immediate worry for Italy in the short term is the imminent scale-back of the ECB's sovereign bond buying program. With an enormous public debt and annual debt-servicing costs of around 70 billion euros, Italy has been one of the biggest beneficiaries of the low-interest-rate environment the ECB's bond purchases have created.

SPAIN: POLITICAL CRISIS LIKELY TO HURT MOMENTUM

Continuing the impressive turnaround it has achieved over the past few years, Spain reported one of the highest growth rates for the third quarter among Euro-zone peers. However, a recent political crisis has weakened the outlook for the country in the near term.

Spain's GDP jumped 0.8% in the third quarter, meeting estimates but slightly underperforming the 0.9% growth recorded in the second quarter. Year-on-year, output expanded 3.1%, the same annualized pace at which it had increased in the second quarter. Also, encouragingly, the country's unemployment rate declined from 17.2% to 16.4% between the second quarter and the third, which is a nine-year low.

Nonetheless, these positive developments were overshadowed by the Catalonia region's demand for independence in early October. The Spanish government has already dismissed the president of Catalonia and his cabinet but the regional leader, who is in self-imposed exile in Belgium, has called for a Brexit-style vote on whether Catalonia should exit the European Union too.

With this crisis simmering, Spain's short-term outlook appears to have weakened. There has been an exodus of businesses from Catalonia, which accounts for about 20% of Spain's GDP. Not surprisingly, the Spanish government has trimmed its 2018 GDP growth forecast from 2.6% to 2.3% as the current uncertainty could affect investment decisions and tourism.