News release

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Eurozone's reliance on Germany for economic growth looks shaky

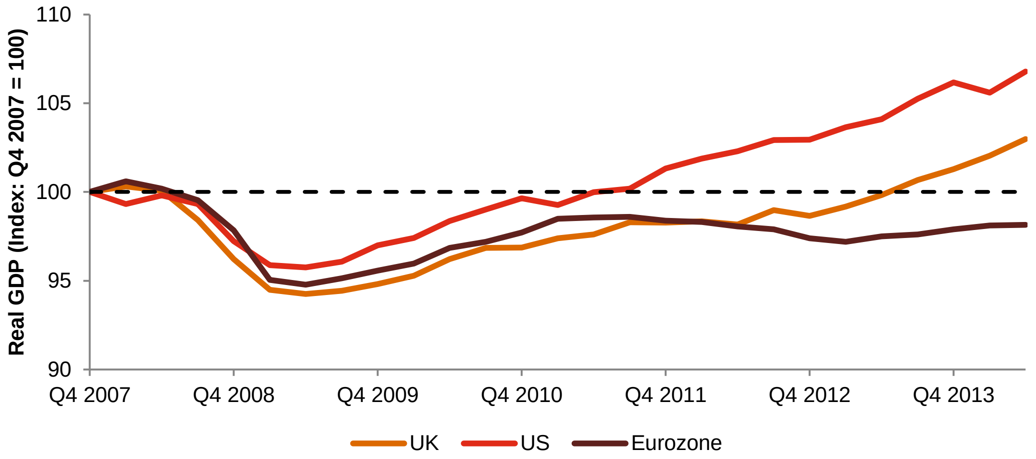
Eurozone growth is stuck in neutral, with Germany unlikely to ride to the rescue according to PwC economists in their latest monthly Global Economy Watch report.

In the aftermath of the financial crisis, the Eurozone relied on Germany to push up its economic growth rate. But in the absence of a pick-up of growth in the core economies of France and Italy – as well as in the Eurozone's periphery economies – this over-reliance on Germany is becoming an issue.

This is because:

- even with reasonably strong growth rates in Germany in recent years, the Eurozone hasn't managed to grow faster than 1% since 2011, and thus its GDP remains smaller than immediately before the financial crisis *(see Figure 1 below); and*
- Germany has itself slowed recently, and faces longer term demographic and economic challenges that could drag down its potential growth rate from around the year 2020.

Figure 1: The Eurozone economy is smaller now than it was at the beginning of 2012 and still hasn't regained its pre-crisis level



Source: Datastream

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Based on our projections, the Eurozone is not expected to regain its pre-crisis GDP level until 2016. Germany and France have already passed this benchmark but our analysis suggests that Italy won't achieve this until around 2023.

PwC economists have downgraded their main scenario growth projection for Germany's GDP from 1.5% to 1.2% for 2014 and from 1.6% to 1.2% for 2015 (see Table 1). Says PwC senior economist Richard Boxshall: "There are tangible signs that external shocks – notably the Ukraine-Russia situation – have affected Germany's short-term outlook."

Table 1: Main scenario real GDP growth projections (%)

	2014	2015
Eurozone	0.7	1.1
Germany	1.2	1.2
France	0.4	0.9
Italy	-0.3	0.6

The Centre for European Economic Research (ZEW) Indicator of Economic Sentiment, for example, has been on a downward trend since July this year and in October fell into negative territory for the first time since November 2012. This is expected to have wider implications on the third quarter Eurozone GDP figure, which will be announced on 14th November.

PwC economists say that in the longer term, Germany needs to overcome three main challenges in order to maintain robust economic growth rates:

- Unfavourable demographics: Germany's working-age population is expected to shrink by around 8 million people between 2010 and 2030;
- Low investment to GDP ratio, with its public investment rates below those of the other core countries; and
- Poor labour productivity in the services sector compared to France and the UK – however, this is offset by Germany's international excellence in the manufacturing sector.

Meanwhile, the other major Eurozone economies are unlikely to be able to play a role in the search for growth impetus. Italy has fallen into its third recession since 2008 (although expected to grow modestly in 2015); and France has stagnated for the first two quarters of 2014 and, in the absence of substantial reforms to its product and labour markets, its outlook remains poor.

Says Richard Boxshall: "While Germany is still expected to achieve positive, if relatively modest, growth for the next two years and remain a key driver of Eurozone growth in the short-term, it does beg the question, how long is this going to last?"

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Note:
The November edition of PwC's *Global Economy Watch* can be found at www.pwc.com/gew

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