Having been highly buoyant in 2017, economic activity in the euro area slowed significantly in 2018 Q1. As seen in Chart 1, the March 2018 ECB staff macroeconomic projections for the euro area had forecast quarter-on-quarter GDP growth of 0.7%, well above the 0.4% actually recorded. This unexpected weakness in activity had been anticipated by the indicators published before the National Accounts figures were made known,[1] as reflected in the economic surprise index compiled by Citigroup (see Chart 2). [2] Moreover, the surprises were a general phenomenon across countries.

To explain the slowdown in output, the information available points to the impact of both temporary factors and other more persistent ones. As regards temporary factors, four circumstances have been highlighted as possibly having affected the performance of activity in Q1. First, production and demand may have been curbed by the unusually adverse weather conditions.[3] However, value-added in construction, one of the sectors in which the effects of bad weather are usually most apparent, was buoyant in Q1, with quarter-on-quarter growth of 0.7% in the area as a whole. Second, in the specific case of the German economy, a winter flu epidemic that was more severe and longer-lasting than usual may have increased absenteeism in February and March. In addition, there was the impact of various strikes in certain important sectors.[4] Finally, the decline in government consumption in Germany in Q1 may be explained by a delay in goods and

1 The preliminary estimate of euro area GDP for Q1 was published on 2 May 2018.

2 Citigroup's economic surprise index shown in Chart 2 is based on the differences between the data published for each indicator and the Bloomberg consensus forecast.

3 In particular, unusually low temperatures were recorded in February and March.

4 Specifically, there were labour disputes in Germany (in the metalworking industry in January) and in France (in the transport industry in March).

Chart 1
QUARTER-ON-QUARTER GDP GROWTH
2018 Q1

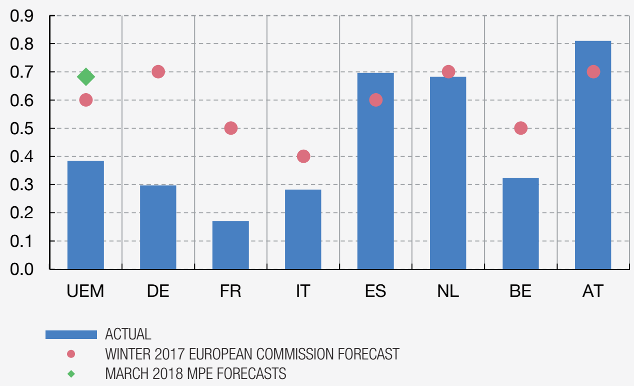


Chart 2
CITIGROUP'S ECONOMIC SURPISE INDEX FOR THE EURO AREA

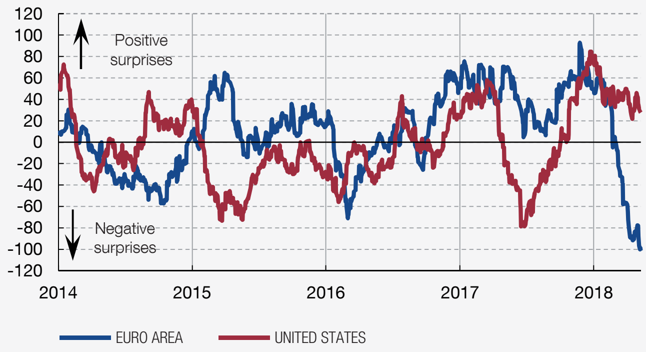


Chart 3
GDP GROWTH AND CONTRIBUTIONS
2017

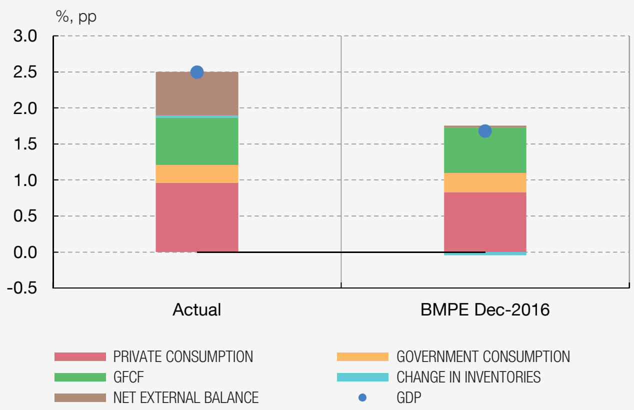
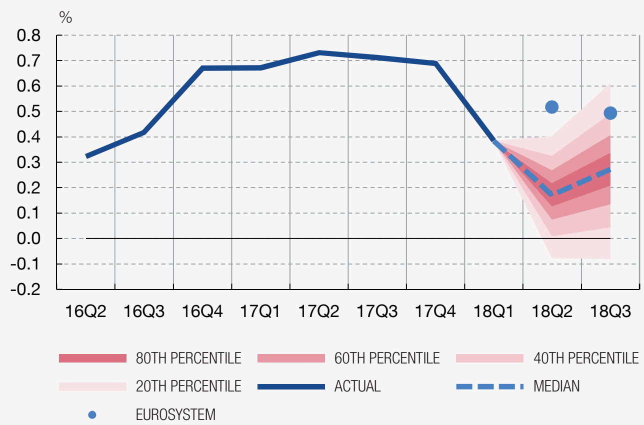


Chart 4
QUARTER-ON-QUARTER GDP GROWTH FORECAST
Euro-sting. 7 June 2018



SOURCES: Eurostat, European Commission, Banco de España and Citigroup.

services purchases owing to the time taken to form a new government. The negative impact of this set of factors on economic activity is difficult to quantify. However, as they are all associated with specific countries and sectors, it is not clear how, on their own, they can explain the strength and broad-based nature of the slowdown.

Consequently, it seems likely that the recent loss of buoyancy is a result of more persistent factors, common to the whole area. Notable in this respect is the sharp slowdown – and in some cases even fall – in exports, in quarter-on-quarter terms, in most euro area countries in 2018 Q1. This behaviour may reflect a reversion of export growth to levels more in line with the cyclical position of the world economy, following exceptionally high growth last year, especially in the second half, when it explained the entire positive surprise in economic activity in the year as a whole (see Chart 3). However, the delayed effects of exchange rate appreciation last year and the slowdown in world trade that some indicators suggest may be happening at the beginning of 2018 may also be having a negative impact on exports. The latest information provided by export-related leading indicators (such as order books and export expectations) suggests that exports continued to slow in Q2.

Leaving aside the search for the origin of activity's loss of buoyancy among the demand components, the information available on Q2 presages lower GDP growth than in 2017 and suggests that there are risks that growth will be below the 0.5% rate contained in the June Eurosystem macroeconomic projections. Indeed, the Banco de España's Euro-sting model,[5] which estimates the short-term growth of the area in real time using the information supplied by a wide range of indicators, suggests that the GDP growth rate in 2018 Q2 will be similar to that recorded in Q1 (see Chart 4).

Nonetheless, the economic fundamentals of the euro area remain robust, so that the current upturn can be expected to continue in the medium term, at rates that are still above the economy's potential growth rate, despite being more moderate than in 2017. Economic activity will continue to be driven by a monetary policy that is still highly accommodative, favourable financial conditions, conducive to greater lending to the private sector, and an expanding labour market, which will continue to shore up household and business confidence when consumption and investment decisions are taken.

5 See M. Camacho and G. Pérez-Quirós (2008): "Introducing the Euro-sting: short-term indicator of euro area growth", Working Papers, No 0807, Banco de España.