



We have been regularly highlighting a dichotomy in the euro-area between hard-data and the more optimistic surveys since Q2 2015. Recently, however, we see a divergence also within surveys. While the numerous consumer confidence indicators published last week surprised on the upside, the contribution of business confidence was negative. We interpret such a divergence as a confirmation of a recovery driven by private consumption, boosted by the fall in oil prices. Disappointing global growth along with financial market stress may be starting to weigh on business confidence.

We expect oil prices to start gradually recovering. This means less of a drag on headline inflation but a fading cyclical boost to real GDP in the second part of the year. Indeed, we think that the pace of the euro-area recovery will peak in 2016. Next year the challenges could intensify unless global growth surprises on the upside.

...stuttering credit impulse

The credit impulse is a useful cross check on the high frequency data captured in *SIREN*. The credit impulse tended to either support or signal upside risk relative to our euro-area domestic demand projections over the past 12 months. The December lending data disappointed.

It is too early to conclude that the trend is reversing. The monthly credit is highly volatile and seasonality in December is notoriously elevated. Still, there are starting to be signs that risks are moving on the downside. The increasing euro-area financial CDS spreads in recent weeks bears watching if it signals a new bout of uncertainty about the monetary union banks.

The euro area remains vulnerable

There are not only conjunctural reasons to be concerned. The euro-area is in a better shape than in the previous two recessions, but it is not healed. The sub-optimal European Monetary Union is not strong enough to ride out from a global storm unscathed.

The ECB can neither solve structural issues at a country level nor for the union as a whole. With only modest exceptions (France), we are pessimistic about further material growth-enhancing reforms or further significant integration, and there are risks of reversal in some cases (Spain, Portugal):

- There has been *progress in the peripherals* and consensus on *France* is overly gloomy.¹ However, the peripherals will remain in a vulnerable position beyond the current decade given their *elevated net external debt* (Spain, Portugal, Ireland and Greece) and/or the low potential growth (Italy, Portugal and Greece).
- The recovery came too late to stop the *rising of populism*. This is an issue in the two systemic peripherals – Italy and Spain – as well as in core countries, including *Germany* and *France*.
- To become less of a sub-optimal monetary union the euro area needs further integration. But *anti-euro sentiment* has risen in the core and the periphery.
- Political uncertainty in *Spain* will not go away, endangering the country's remarkable comeback. A new election is a question of *when* rather than *if*.
- Relative to expectations, *Italy's GDP* has disappointed more than Latin America over the past five years (Figure 6). There have been some

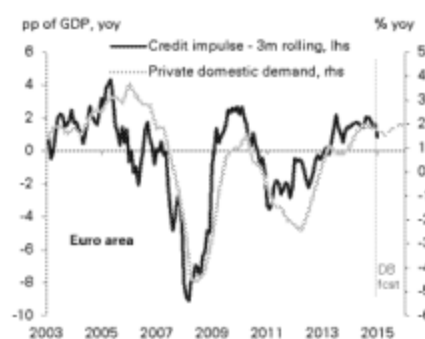
¹ See "France: labour reform on the right path", page 12 in Focus Europe on 22 January.

Figure 4: *SIREN*-surprise at 15-month low



Source: Deutsche Bank

Figure 5: Stuttering credit impulse



Source: ECB, Eurostat, Haver Analytics LP, Deutsche Bank

Figure 6: Past five years real GDP outturns versus one-year ahead expectations



* For Italy, Euro area and Japan, actual GDP for 2015 is assumed to be in line with latest Bloomberg forecast
Source: Bloomberg Finance LP, IMF, Deutsche Bank