

Euro area growth conditions are set to brighten

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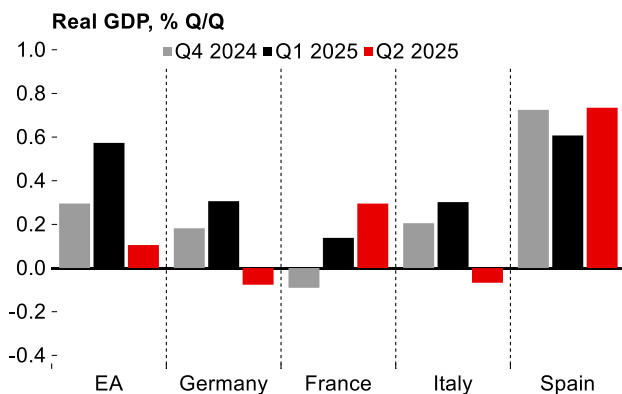
• The euro area economy managed to eke out a small expansion in Q2 (+0.1% Q/Q) despite tariff volatility. Despite the deceleration from Q1, the national releases suggest a degree of underlying domestic resilience. With surveys picking up in recent months and the apparent reduction in US trade-related downside risks there is now a decent platform in place for better growth in H2. We are now pencilling in a figure of 1.2% for 2025 as a whole, up from 0.9% previously.

• In terms of the ECB outlook, the bar for further rate cuts has clearly risen in recent weeks, but we still see scope for more easing. In a separate release out today the ECB's latest negotiated wage numbers continued to point to lower services price pressures ahead.

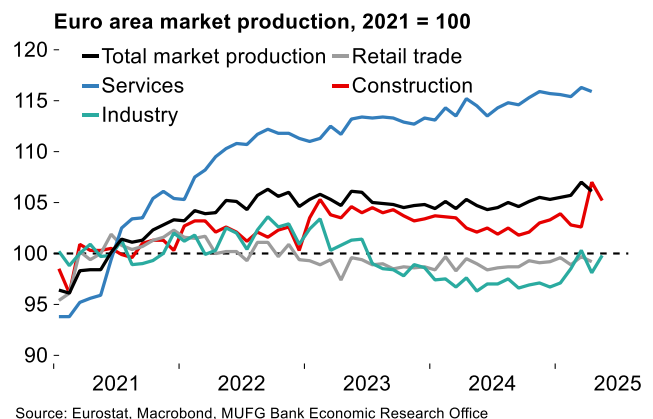
Muted growth, but growth nonetheless

The euro area economy expanded by 0.1% Q/Q in Q2, in line with our expectations and slightly above consensus (0.1%). The Q1 figure was left unrevised at 0.6% Q/Q. The sharp slowdown is no shock after fast start to the year (see [here](#)) – and indeed it's encouraging that the economy eked out any growth at all after the reversal of the US frontloading boost.

Growth predictably slowed a strong Q1 – but, with support from Spain, the euro area avoided a contraction



There have been some signs of a cyclical recovery in euro area industry



By country, the German economy experienced a mild contraction in Q2 (-0.1% Q/Q, in line with expectations). While there's no expenditure breakdown available at this stage, the release noted that both household and government consumption contributed

positively to growth. Retail sales for June, also out today, showed some momentum into Q2 with growth of 1.0% M/M.

It was a similar story in Italy with a mild contraction (-0.1% Q/Q too) but with a positive contribution from domestic demand. It's no surprise that Italy and Germany, the most exposed major euro area economies to US demand, experienced a contraction in Q2. But the details are more reassuring with signs of underlying resilience from a domestic perspective.

There's a clear contrast with the French economy which grew relatively strongly in Q2 (+0.3%), but that was essentially just an inventory story (+0.5pp). The breakdown showed weak consumer spending (0.1% Q/Q) and a drag from fixed investment. It's a tough outlook for the French economy amid political uncertainty and fiscal consolidation efforts (see [here](#)).

Elsewhere, the Spanish economy continues to motor along and maintain the narrative of outperformance relative to the rest of the euro area. Growth came in at 0.7% Q/Q in Q2, up from 0.6% in Q1, driven by households and investment. There was a small drag from net exports with Spain less exposed to tariff tensions.

Conditions are set to improve in H2

Looking ahead, there is a reasonable platform for euro area growth now in place. Last week's survey data, in the round, came in above expectations. The composite PMI reached an 11-month high, driven by a healthy bounce in the services component, and today's European Commission survey also came in better than expected.

While there has been a negative reaction to the EU-US trade deal (see our initial take [here](#)) from many quarters, the agreement of a framework does mean that downside risks around escalation have reduced which could further support sentiment. We estimate that 15% tariffs will equate to a drag of around 0.2% of GDP – not ideal, but manageable.

As things stand, euro area surveys are, in the round, consistent with slightly firmer growth in Q3. With German fiscal stimulus coming down the track and the ECB's return to a neutral policy setting, the conditions are there for the euro area economy to sustain growth at a healthier clip.

We will release our next full set of forecasts in coming weeks but, as we noted earlier this week, our central scenario had been for US tariffs on EU goods to settle at 20% after a bumpy negotiation process. While risks remain and plenty of details are lacking, the agreement of a framework in itself is a more benign outcome than we expected. Accordingly, we are set to revise up our GDP forecast for 2025 (previously 0.9%). For now we are pencilling in a figure of 1.2%, which if achieved would be the first time that annual euro area growth has exceeded 1% since 2019, if the post-pandemic rebound is excluded.

In terms of the ECB outlook, policymakers will certainly note this picture of broad resilience in the Q2 GDP figures. When combined with the reduction in tariff-related downside risks and some reversal of euro strength, the bar for further cuts is certainly higher (see our take on last week's meeting [here](#)). However, separate data today in the form of the ECB's negotiated [wage tracker](#) continues to point to easing services price pressures next year. We still expect more ECB easing ahead, which could further support sentiment and growth conditions.

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