Special Bulletin

A Japanese Perspective on the International Energy Landscape (184) August 28, 2014

Slumping Eurozone Economy and Growing Fears of Long Stagnation

Ken Koyama, PhD
Chief Economist, Managing Director
The Institute of Energy Economics, Japan

On August 14, preliminary real gross domestic product (GDP) data were released for the second quarter of this year in the European Union, indicating an economic slowdown in European countries, particularly the Eurozone economy. As is well known, the Eurozone consists of countries that have acceded to the European Union and adopted the common currency of the Euro. The Eurozone members number 18 including major European continent countries such as Germany, France, Italy and Spain, as well as Latvia that joined the zone most recently in January 2014. The United Kingdom and Sweden are not included into the Eurozone. In 2013, the Eurozone's economic size came to $12.8 trillion in terms of GDP, accounting for 17% or the second largest share of the world economy after the United States. (China was the second largest, as a country with $9.2 trillion in terms of GDP).

In the 2nd (April-June) quarter, Eurozone GDP leveled off from the previous quarter, meaning zero growth. Before the deceleration, the Eurozone economy had maintained positive growth since the 2nd (April-June) quarter 2013. While GDP performances were patchy among Eurozone countries, major Eurozone members Germany, France and Italy were slumping remarkably.

Among them, Germany as the largest European economy saw its GDP posting a real 0.2% contraction after a 0.7% increase in the previous quarter, a remarkable slowdown. France logged zero growth for the second consecutive quarter. Italy recorded a 0.2% contraction after a 0.1% decline in the previous quarter, indicating a recession defined as two consecutive quarters of contraction. Major contributors to the slump reportedly included sluggish overseas demand and nonresidential investment. Also among these factors may be economic sentiment that has deteriorated due to the Ukraine situation, which grew tense rapidly in February and has become even more serious instead of being improved.

Behind the greater-than-expected economic deceleration in Germany and some other countries are some special factors including fewer business days as a calendar factor and a reaction to robust construction demand amid a warm winter in the previous quarter. GDP data in not only Germany but also many other countries are thus viewed as worse than actual. In fact, some forecast that if European economy driver Germany gets back on a growth path, with other European countries achieving positive growth, through the disappearance of special downside factors, the entire Eurozone economy may not go back into a recession.

But no optimism can necessarily be warranted. Among various conceivable uncertain factors, the most important and uncertain factor at present is the impact of the Ukraine situation, particularly the impact of deterioration in Eurozone countries' relations with Russia on the Eurozone economy.

The Eurozone economy including Germany has had deep, close relations with Russia. Therefore, EU or European countries had maintained a prudent approach while gradually toughening economic sanctions on Russia amid developments in the Ukraine situation since February. Since July's shoot-down of a Malaysian Airlines jet, however, Europe has grown tougher against Russia, enhancing Russian economic sanctions including financial transaction restrictions. In response, Russia has banned its import of some food products from Western countries, indicating an expanding negative spiral. As a matter of course, the direct impact of Russia's food import restrictions on European GDP may be limited. But the possible escalation of Europe's economic sanctions, further deterioration of Europe-Russia relations and geopolitical uncertainties may worsen business and consumer confidence. This could be an additional downside factor for Europe and the entire Eurozone economy.

The Financial Times on August 22 reported Nobel economics prize winner Joseph Stiglitz as saying Europe was on a path to an equivalent to the lost decade that Japan had experienced. It is uncertain whether Europe would actually experience any long economic slump. But the recent situation does not allow us to be optimistic. European countries may be required to seriously consider how to avoid any long slump and to implement the avoidance.

A deceleration or slump in the Eurozone and the European economy will variously affect international energy markets as a matter of course. A slowdown in the second largest economy after the United States will dampen energy demand and ease the supply-demand balance. Crude oil prices' accelerated decline in August after their rapid rise amid the Iraqi turmoil from June might have been attributable to a (possible) demand fall through a European economic slump as well as supply factors such as the absence of the Iraqi turmoil's direct impact on oil supply and Libya's oil output expansion.

Europe's net liquefied natural gas imports in the first half of 2014 reportedly declined 16% year on year basis. Europe's demand is thus falling in the natural gas/LNG market as well. Any easier supply-demand balance in international oil, gas and LNG markets would be good news for Japan as a major energy importer. If the easier energy supply-demand balance results from an economic deceleration in Europe as a major economic zone, however, it may be a matter of grave concern from the viewpoint of the world economy. We may have to closely watch European and Eurozone developments from the viewpoints of the world economy, international politics and the whole of energy markets.

Contact: report@tky.ieej.or.jp

The back issues are available at the following URL

http://eneken.ieej.or.jp/en/special_bulletin.html