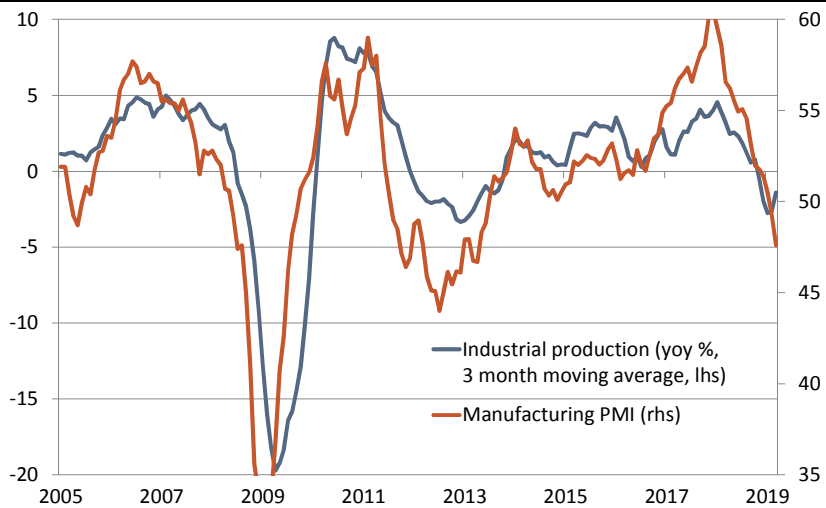




22 March 2019

Eurozone industry: still stuck in the grey winter

Eurozone manufacturing PMI and industrial output



Purchasing managers' index for Eurozone manufacturing, right-hand scale; yoy changes in Eurozone industrial output, left-hand scale. Sources: Markit, Eurostat

- External shocks:** No other factor shapes the Eurozone business cycle more than the ups and downs of global trade. In 2017, net exports contributed 0.8ppt to the region's unusually strong growth rate of 2.5%. Following a series of external shocks, net exports subtracted 0.3ppt from the Eurozone's annual rate of GDP growth in H2 2018 instead. The drop in the region's manufacturing PMI to a 71-month low of 47.7 in March from 49.4 in February, highlights the risk that, near term, trade may turn even more negative. In March, Eurozone manufacturing suffered the sharpest fall in export orders since August 2012 – the end of the euro crisis.
- A split economy:** So far, the severe hit from trade has not fully hit the domestic economy yet. Final domestic demand still added 1.4ppt to aggregate GDP growth in H2 2018 after 1.8ppt in 2017. In the services sector, the PMI dropped only slightly to 52.7 in March after 52.8 in February, remaining well above 50 and thus signalling growth. The separate European Commission survey of consumer confidence even edged up in March to -7.2 from -7.4 in February, the third gain in a row and above the long-term average of -11.3.
- How long can the domestic economy hold up?** Eurozone consumers are partly shielded from the woes of export-oriented manufacturing as: i) companies still have a sufficient backlog of orders despite a dearth of new business; and ii) exporters are unlikely to dismiss significant numbers of workers amid a general shortage of qualified staff. However, domestic demand cannot decouple from the external economy forever. Unless external demand bottoms out soon, business investment and – to a lesser extent – private consumption could suffer noticeably.
- The grey winter continues:** Our forecast for Eurozone growth of 1.1% in 2019 remains well below the Bloomberg consensus of 1.2%, as it has been since late 2018. The risks to our call are tilted to the downside. At the moment, the Eurozone economy is probably expanding at an annualised pace of 0.8% at most. Unless the external risks fade somewhat in coming months, the continuing downside momentum in confidence surveys could point to stagnation in Q2.
- A delayed rebound:** We maintain our view that the external environment will improve if and when the US and China defuse their trade tensions, the Chinese monetary-fiscal stimulus starts to work and the risk of a hard Brexit fades. We expect these conditions to be met in a few months – see [First signs of spring?](#) So far, however, the US-China trade talks are still dragging on, the Brexit noise has reached fever pitch and the Chinese stimulus still needs time to be administered (tax cuts) and work. While the case for a rebound in Eurozone export expectations and GDP growth later in 2019 remains strong, the risk that it could be delayed beyond spring has now risen.

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