Snap | 18 April 2019

Eurozone: A cold spring

April PMIs - the first glimpse on second quarter activity, came out weaker than expected. It looks as if eurozone growth is having trouble shifting into higher gear, justifying the ECB's recent dovish stance

Source: Shutterstock

The flash estimate for eurozone's composite PMI indicator for April came in at 51.3, a decline from 51.6 in March and once again undershooting the consensus expectation of 51.8. The Manufacturing PMI rose to 47.8, though this is still in contractionary territory. The service sector PMI fell back to 52.5 from 53.3 in March. New order growth picked up slightly, but new export orders fell for the seventh straight month. Employment growth increased but remained among the lowest since 2016. Although cost inflation was higher, partially driven by higher oil prices, average prices charged for goods and services rose at the slowest rate in 20 months, a testimony of the current lack of pricing power. No wonder consumer price inflation is still going nowhere.

Not all is bad

Since the second quarter of 2018, the eurozone economy has been persistently undershooting expectations. Today's figures continue this long string of underperformance. But we shouldn't get too pessimistic either. The recent upturn in China is a boon to Europe's economy as it is much more dependent on foreign demand than the US.

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At the same time, central banks in major economies have become more dovish leading to easier financing conditions and buoyant financial markets. But even then any upturn is likely to remain muted. The Brexit story might still end in tears, while potential trade tensions with the US are lurking around the corner. On top of that markets could start to focus again on the deterioration of public finances in a number of member states, especially in Italy.

Rest assured: the recovery is still in place, but at the same time we have to acknowledge that the business cycle is already in an advanced stage and that a growth pace of more than 0.3% quarter-on-quarter is getting harder to realise. The second quarter already started on a bad footing, but we are still comfortable with our forecast of 1.2% GDP growth for the whole of 2019.

ECB to buy time

Where does this leave the ECB? We think a big sigh of frustration was heard in Frankfurt after the publication of the PMI figures today.

If economic data continue to disappoint, the ECB will be forced to think of additional stimulus, a big U-turn after having stopped net asset purchases in January. However, the ECB will likely try to buy time, giving the uncertainties surrounding the current growth outlook. The terms of the new TLRTOs still have to be determined and we believe that the ECB will wait as long as possible to do this, allowing it to decide on more favourable conditions for the banks if the expected growth improvement should fail to materialise.

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