

## Eurozone economic recovery on track for strong growth in 3Q

The Economic Sentiment Indicator declined in August, but still signals strong growth for 3Q



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The ESI decreased from 119 to 117.5, which is in line with the trend seen in other survey indicators released earlier like the PMIs. The high level indicates that growth remains strong for 3Q, but it does show that rebound growth has probably peaked and is set for moderation from here on. Here are four key take-aways from the release:

### 1 Delta fears cause services sentiment to weaken

Delta fears seem to have the largest impact on weakening sentiment at the moment. Small declines in the indicator for observed business activity in services seem mostly in line with reopening effects wearing off. Expectations for the months ahead are weakening at a faster pace though and could result from a similar effect, but here the fear of the delta variant of the coronavirus is also important to keep in mind. With expectations of an autumn resurgence of the virus, stricter corona measures are an important downside risk to the outlook.

## Shortages are starting to bite for industry

The most remarkable number in today's ESI release was the sharp decline in observed production in manufacturing. With new orders still coming in at a rapid pace, expectations for the months ahead remain strong, but current production has been hampered by supply chain problems and input shortages. Especially in the auto sector, this has caused temporary shutdowns of production and this August reading does not bode well for the 3Q industrial contribution to GDP growth, indicating that most of the heavy lifting will still come from the reopening of the service sector.

### 3 Inflation pressures remain high as core inflation is set to jump

The ESI indicated that August selling price expectations for goods reached a record high. This confirms expectations of above target inflation for the ECB until at least the end of the year and adds upside risk to the inflation outlook. Tomorrow's inflation reading for August is already expected to take core inflation much higher – we expect it to increase from 0.7% to 1.4%. We expect it to remain elevated for most of 2H as the German VAT hike, pricing through of cost increases and reopening in services cause upward pressure on core inflation.

### 4 Some small question marks about the industrial job market recovery

The bounce back in employment has been very strong in recent months as economies reopened, which has been an encouraging sign for the sustainability of the recovery. Today's release does reveal a downturn in employment expectations from industry, which begs the question whether this is because of the limited availability of qualified workers or because labour demand has been fulfilled. We expect it to be the prior given continued strong demand for goods, but labour shortages could also cause the job market recovery to go into a lower gear. For services, employment expectations have peaked at a historically high level, indicating that demand for workers remains strong as the economy continues to recover from the corona crisis.

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