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Eurozone economic sentiment provides mixed signals about recovery

The economic sentiment indicator increased less than expected in May, from 64.9 to 67.5. A further deterioration in services sentiment despite easing lockdowns buries hopes of a swift recovery

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Just a small tick up in sentiment after the historical drop in April was not what was expected for May. Economies are starting to reopen and most eurozone countries saw the bottom in terms of daily activity at the end of April. With factories also reopening, a larger improvement in sentiment was to be expected. While industry saw sentiment bounce back from -32.5 to -27.5, services sentiment deteriorated further from -38.6 to -43.6.

By country, France saw a further deterioration in May as the lockdown continued through the survey period, while countries like the Netherlands and Germany saw above average improvements. Austria, which was the first to ease measures and announce an exit path out of lockdown, saw a marked improvement in economic sentiment from 61.9 to 68.8. This suggests that domestic lockdowns continue to dominate the economic situation for the moment.

The decline in services sentiment was mainly due to a fall in recent demand and the business situation, but we did see improvements in expected demand for the months ahead. This suggests that the gradual easing of measures may have a slight delayed effect on output recovery. For industry, a similar pattern emerges, but the decline in recent production was much smaller than in April and expectations for production in the months ahead have been lifted even though order books are still falling.

A continued reason for concern about the recovery is the expectation for employment in the months ahead. While service sector businesses are becoming more optimistic about demand, they are becoming more pessimistic about employment expectations in the months ahead. In industry, employment expectations were only slightly above April readings. This indicates that the increase in unemployment is likely to continue for the months ahead, dampening hopes of a swift recovery.

For the European Central Bank, today's data indicates that continued monetary support is important. The economy is not going through a V-shaped recovery and higher unemployment will only drag out the recovery phase. At the same time, businesses are indicating very weak price pressures at the moment, making deflation in the short-run and more deflationary pressures in the medium-term a likely scenario.

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