Eurozone economic sentiment reveals more bad news about inflation

Large jumps in selling price expectations are triggering further concern about eurozone core inflation in the coming months. Meanwhile, the reopening of many service sectors as Covid restrictions end is, at least for now, lessening the economic impact of the Ukraine war

A car factory in Dieppe in France

Economic sentiment fell by 5.4 points to 108.5 in March. The largest drop in confidence was among consumers, but manufacturing businesses also saw industrial confidence drop markedly. It's not so much due to recent developments in production, but expectations fell significantly. Order books remain well filled, but supply chain problems are already causing production shutdowns here and there, which is a reason for pessimism about the months ahead.

The service sector is set to rebalance some of the negative impact of manufacturing production hiccups in March. The positive impact from the reopening of economies has boosted recent demand for service sector businesses and despite high prices, demand expectations continue to improve for the months ahead. If they are right to be optimistic remains to be seen as inflation is set to trend far higher than we see already.

Indeed, the most important takeaway from the survey is that selling price expectations for both services and industry are soaring at the moment. The higher input costs due to jumps in energy prices and further supply chain problems translate into higher core inflation in the short term. This brings further upside to our eurozone inflation expectations which were already above 7% for March.

In the coming months, expect purchasing power to be squeezed substantially, together with production hiccups thanks to renewed supply chain problems. We expect that combination to cause GDP growth to turn negative in 2Q, followed by recovery. So while economic activity may have been supported by services activity in 1Q, things are looking worse for the months ahead.

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