Eurozone economic sentiment worsens in April

The European Commission's Economic Sentiment Indicator worsened in April, while price expectations reached a new all-time high. The risk of stagflation in the eurozone is increasing.

Economic sentiment weakened in April. The European Commission's economic sentiment indicator (ESI) dropped to 105.0, from a sharply downwardly revised 106.7 in March. Initially, the March number had come in at 108.5. While industrial and consumer confidence dropped further, confidence in the services sector held up relatively well. However, even in the services sector confidence is currently lower than at the start of last summer, suggesting that the war in Ukraine is already overshadowing the positive impact from reopening.

Price expectations in this survey will give policymakers at the European Central Bank a headache. Both in the manufacturing and services sector, selling price expectations reached a new all-time high. Only households’ price expectations came somewhat off the all-time highs.

Worsening outlook explains rush of some ECB members

Today’s ESI shows that the outlook for the eurozone has worsened but has not (yet) plunged sharply. In fact, the drop in economic sentiment reflects the high uncertainty going forward. There is still hardly any hard data available which could qualify the economic impact of the war in Ukraine. We are currently still stuck with scenario analysis and forecasts. However, to some extent, available components of GDP developments at the country level in the first quarter already show that private
consumption took a severe hit from high energy and commodity prices and that corporates have started to build inventories. The latter could be the result of a transition from just-in-time processes to 'just-in-time plus x months' processes. The lockdowns in China, as well as the war in Ukraine, will weigh on supply chains, not only increasing price pressures further, but also creating additional production disruptions and delays. Add to this the currently discussed ban on Russian oil imports and the pending scenario of supply disruptions of Russian gas, and risks to the economic outlook are clearly tilted to the downside. This worsening economic outlook could also explain why some ECB members seem to be in a rush to hike interest rates. The fear seems to be that the window of opportunity to end net asset purchases and start the rate lift-off could be closing rather soon. This is why we can no longer exclude a first rate hike in July, possibly followed by a second rate hike in September.