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Eurozone economy ends 2018 on a very weak note

The economic sentiment indicator of the European Commission fell in December 2018 to the lowest level since January 2017, reducing the chances of a rate hike in 2019

Anyone looking for fireworks in today's economic data for the eurozone, should look elsewhere. The European Commission's economic sentiment indicator (ESI) fell back to 107.3 in December 2018, from 109.5 in November. The outcome was worse than expected (consensus estimate 108.2). France, on the back of the Yellow Vest protests, saw a significant decline (-2.0), but amongst the bigger countries, Germany (-1.9), Italy (-1.4), the Netherlands (-0.3) and especially Spain (-3.0) also saw a drop in confidence.

Extended weakness

Weakness was widespread across sectors. The export-oriented manufacturing sector (-2.3) felt the pinch from slower growth in the emerging world. But the services sector also saw confidence decline (-1.4). Consumer confidence took a 2.3 point hit, while sentiment in the construction sector also deteriorated. The only bright spot was a small uptick in retail trade confidence, but that only concerns the present situation, as expectations became less upbeat. The worrying news is the fact that the more forward-looking indicators like order books and hiring intentions have also lost momentum, implying that the slowdown might extend into the first half of this year.

In terms of inflationary expectations, the picture is mixed. Selling price expectations increased across the board, but consumer price expectations fell back. We have doubts that slowing demand and the strong euro in effective terms will allow businesses to raise prices. Therefore we do not see much upward inflation potential this year.

Diminishing rate hike expectations

Let's not beat about the bush: this is a bad report, signalling a weak fourth quarter and not promising much better for the first quarter of 2019. These figures confirm our view that the GDP growth forecast for 2019 that the ECB issued only a few weeks ago (1.7%) will have to be downgraded significantly. That strongly reduces the probability of a rate increase this year. We might see at most one deposit rate hike, but the bottom line is that money market rates are likely to remain negative for at least another year.

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