Snap | 30 January 2019

Eurozone economy still suffering from winter blues

The economic sentiment indicator of the European Commission fell further in January. While forward-looking indicators don't point to much improvement in Q1, consumers are offering a glimmer of hope

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Sentiment cools further

With the winter cold, business sentiment seems to have fallen below the freezing point.

The European Commission's economic sentiment indicator (ESI) continued its decline in January to 106.2 from 107.4 in December last year. The outcome was worse than expected as the estimated consensus was 106.8. The bigger countries including Germany (-0.8), Italy (-1.3) and the Netherlands (-4.1) saw confidence slip, while it remained broadly stable in Spain (+0.1). What's interesting is that despite the 'yellow vest' protest, France actually saw a 0.5 point pick-up in sentiment.

The manufacturing sector (-1.8), the services sector (-1.2) and retail trade (-1.8) all saw a drop in confidence. However, construction confidence actually increased (+0.9). Another positive note was the 0.4 point rise in consumer confidence.

Forward looking indicators are not helping

Where do we go from here? Forward-looking indicators like order books and production expectations in the more cyclical manufacturing sector don't bode well for first quarter growth. Export order books also took another hit. Industry mentioned a significant drop in the competitive position on foreign markets outside the EU.

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On a more positive note, employment expectations have risen in retail trade and the construction sector, though they have lost ground in both industry and services. For the time being, consumers seem less worried about unemployment, which could support consumption in the coming months.

In terms of inflationary expectations, we are still far from a sustained uptick. Selling price expectations increased slightly in services but fell back in retail trade, construction and industry. Consumer price expectations also retreated in January. With businesses worrying about their competitive position, we just don't buy the ECB's story that higher wages will be eventually passed through to the consumer. Today's figures seem to corroborate our view.

No all gloom and doom

While the GDP figures coming in for the fourth quarter are less dramatic than one could have feared (e.g. +0.3% in France), there are no signs of an acceleration in GDP growth.

On the contrary, the lasting uncertainty surrounding Brexit, the threat of further trade skirmishes and a difficult political climate are pushing businesses into wait-and-see mode. It is telling that the share of managers who see their current production capacity as more than sufficient, increased markedly. Fortunately, consumer confidence is no longer falling, which at least offers some hope that it cannot only go downhill from here.

At this point, we think the risk of a recession this year still remains low, unless all downward risks materialise. That said, the best now lies behind us, and Eurozone growth should come out between 1.0% and 1.5% in 2019, nothing to cheer about. We, therefore, think ECB policy will have to remain very supportive and we expect the ECB to decide on a new (T)LTRO for the banks by June, to keep easy credit conditions in place.

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