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Snap

Eurozone: Leaves are falling, so is the PMI

A fall in the PMI in October signals a weakening of Eurozone momentum at the start of the fourth quarter. If the stock market corrects further, it would constitute an additional brake on the Eurozone's growth pace

52.7

Eurozone PMI, October
From 54.1 in September

With markets getting increasingly nervous about the Italian budget story and the Brexit troubles, it is important to have a good grip on the underlying growth picture. The flash PMI for October gives a first glimpse on where the Eurozone economy is heading. And the picture is not terrific.

The composite flash PMI fell to a 25-month low of 52.7 from 54.1 last month, with the manufacturing PMI coming in at 52.1 (from 53.2 in September), while the Services PMI shrunk to 53.3 from 54.7. Sentiment in the more internationally oriented manufacturing sector is already suffering from concerns regarding trade wars, tariffs, Brexit and an overall increase in political uncertainty. Manufacturing orders actually fell for the first time since November 2014. But the cooling is also spilling over to the services sector.

Employment growth continued to rise, though the pace of growth is weakening. At the same time price pressures remain important. While they are already easing somewhat in the manufacturing sector, services sector charges rose at one of the strongest rates in a decade.

How dangerous is the recent stock market rout in terms of the growth outlook? While you could argue that the stock market is tanking precisely because of fears of a severe slowdown, the relationship actually runs both ways. Falling asset prices reduce wealth and can thereby affect consumption and growth. Although most empirical studies find that the marginal propensity to consume out of equity wealth is lower in the Eurozone than in the US, the impact is certainly not zero. Recent work by the ECB shows that 1 euro change in financial wealth results in 0.7 cents worth of change in consumption in the short run and 4.5 cents in the longer run. So, a further decline in stock markets might be a modest brake on consumption growth. On top of that tanking stock markets could also weigh on business confidence, thereby affecting investment decisions. But before getting carried away by this reasoning we should still remember that the correction until now remains limited. Only when we get another 10 to 15% decline, we really should start to worry about the negative growth impact.

While today's figure is not yet a sign that an economic winter is near, it certainly confirms our story that peak growth is now surely behind us. The PMI figure is compatible with a 0.3% Quarter-on-Quarter GDP growth, a deceleration from the pace seen in the first half of the year. Thanks to base effects average GDP for this year is still likely to come out at 2.0%, but the current growth pace means that next year's GDP growth will fall back to something close to 1.5%.

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