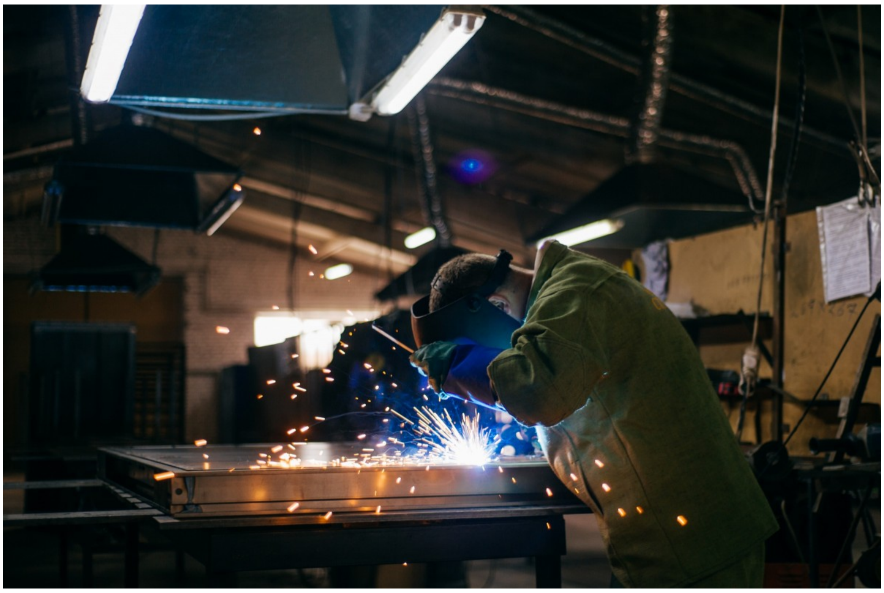
Eurozone PMI falls further into recessionary territory

A weaker-than-expected PMI confirms that the eurozone is now in recession. While pipeline price pressures are gradually abating, it seems too soon to give the all-clear on consumer price inflation. The European Central Bank (ECB) will therefore remain in tightening mode until the first quarter of 2023



Downturn confirmed

The eurozone composite PMI flash estimate fell to a lower-than-expected 47.1 in October, from 48.1 in September. This is not only a 23-month low but is also the fourth consecutive month that the PMI has been below the 50 boom-or-bust level, clearly suggesting negative GDP growth. The manufacturing PMI came out at 46.6, while the services sector PMI is now at 48.2. The steepest downturns were seen in the most energy-dependent industries, such as chemical and plastics and basic resource sectors. Industrial powerhouse Germany saw the fastest decline in activity, while in France growth merely stalled.

Forward-looking components of the survey don't herald any improvement in the coming months – on the contrary. New orders for goods and services fell for the fourth month in a row. Excluding the Covid-19 pandemic, manufacturing orders saw the biggest drop since April 2009, while the decline in new business inflows into service sector companies was the strongest since June 2013. No wonder that backlogs of orders fell for a fourth consecutive month, especially in manufacturing. While there was still modest employment growth in October, there seems to be job cutting at some firms and hesitancy to hire in the wake of the uncertain economic outlook. This means that the job market is likely to be less of a support for consumption in the coming quarters.

Too soon to give the all-clear on inflation

In this rapidly weakening economic environment, supply chain delays have eased to the lowest in just over two years. Manufacturers also bought fewer inputs, reflecting lower production plans and inventory reduction policies in the wake of weakening sales. Easing raw material supply constraints were partially offset by rising energy costs and upward wage pressures, keeping the overall rate of input cost inflation elevated. This still translated into a high rate of increase in prices charged for goods and services, with rates of selling price inflation cooling only marginally in both manufacturing and services. While it seems obvious that upstream price increases are now softening, it still seems a bit too soon to give the all-clear on consumer price inflation.

This is one of the last important economic data the ECB disposes of in the run-up to the meeting of the Government Council on Thursday. While in our view today's figure clearly confirms that the eurozone economy is already in recession, the ECB has made it clear that a downturn would not deter it from tightening monetary policy, as long as inflation is not brought under control. With inflation hovering around 10%, the bank surely wants to restore its credibility. We therefore pencil in another 75bp hike this week and 50bp in December. As inflation is likely to start to come down in the first quarter of 2023 and signs of recession will become more prominent, we think the ECB will stop tightening after the February meeting when we expect the deposit rate to have reached 2.25%.

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