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Eurozone PMI shows worsening contraction in January

The second wave is turning into a long drag on the economy with large differences between sectors emerging. Expect GDP to decline again in 1Q

A factory in the Netherlands

The composite PMI fell from 49.1 in December to 47.5 in January. That drop was to be expected as the survey for December was conducted ahead of stricter measures introduced in Germany and the Netherlands, which is now reflected in the January numbers. Overall, the contraction in business activity indicated by the survey remains mild compared to the first wave impact, but the impact of the second wave is much more spread out over time. With lockdowns being extended further into 1Q, the risk is that sectors bearing the brunt of this face a much more significant, longer lasting impact, such as bankruptcy.

With that, a K-shaped scenario is unfolding over the course of the second wave. Several sectors continue to recover while others are contracting further. Manufacturing is clearly an outperformer. Even in January it continued to recover, according to the manufacturing PMI, which fell from 56.3 to 54.5, a reading still reflecting robust growth. The service sector comprises most parts of the economy that are impacted by shutdowns and social distancing, causing the services PMI to fall further from 46.4 to 45. That indicates significant contraction. The impact of the new German lockdown has been mild so far on aggregate output which is mainly because of the stellar manufacturing performance despite contraction in services.

With lockdowns now extended into February and more aggressive variants of the virus increasing the risk of further extensions being necessary, expect this pattern to continue. Manufacturing growth moderating and a sharp contraction in services will lead to a first quarter contraction in GDP. A bleak start to a year which should, at some point, see a quick turnaround in economic output as vaccinations take hold.

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