

Eurozone: sentiment takes nosedive but there's a silver lining

The impact of the large drop in sentiment on GDP could be limited as service sector sentiment improved, indicating still limited spillover effects from the manufacturing sector at the end of 3Q



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The most important takeaway from the ESI – down from 103.1 to 101.7 in September – is that the spillover from weak manufacturing to services remains muted, which is at odds with the message from the PMI earlier this week. This signals that the problem remains somewhat isolated to manufacturing for now, although the service sector will ultimately feel the repercussions if this lasts much longer.

Industrial sentiment was dismal in September, dropping from -5.8 to -8.8. This was because of a deterioration on all fronts: recent production, current order books, and production expectations all declined. This provides a clear indication that an end to the industrial slump is not yet in sight.

Service sector sentiment improved from 9.2 to 9.5 in September though. This was a small recovery from a larger August drop but it indicates some stabilisation in the sector, which is needed for continued GDP growth given the contraction in manufacturing. Most encouraging underlying indicators were related to the labour market. More optimistic assessments about recent hiring and

future employment needs provide some hope that labour market strength can keep domestic demand afloat.

The message from short-term indicators continues to be worrying. GDP growth in 3Q will come in very muted and the question is whether spillover effects will worsen in the fourth quarter when Brexit risk and tariffs on Europe potentially come to the fore. Monetary leading indicators do signal improvements mid-2020, which is of course very conditional on geopolitical risks. Hold on to your hats, we are in for a couple of exciting quarters.

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