Snap | 27 April 2023

Improvement in eurozone economic sentiment starts to level off

The European Commission's economic sentiment indicator stabilised in April, although the manufacturing sector is struggling. Inflation expectations have eased, suggesting that the peak in underlying inflation has been reached

Consumer confidence increased by 1.6 points in April, with people more optimistic about their financial situations

Consumption saves the day

The European Commission's economic sentiment indicator stagnated at 99.3 in April, following a reading of 99.2 in March.

Industrial confidence declined for the third month in a row (-2.1) and is unlikely to see much of an improvement in the coming months. Order books have deteriorated, inventories are still at too high a level and production plans have been scaled down. Interestingly, employment expectations have also started to soften.

Confidence stabilised in construction. While order books softened, employment expectations still improved. However, with real estate markets tanking in a number of member states and mortgage demand falling, it seems likely that the construction sector will see some weakness in the second half of the year.

At the same time, sentiment improved in both the services sector (+0.9) and the retail sector (+0.5), both of which depend strongly on domestic consumption. And indeed, consumer confidence increased by 1.6 points in April, with a better assessment of the financial situation as one of the main drivers. The strong decline in energy prices and rising wages are certainly contributing to this.

So, for the time being, eurozone growth is being driven by stronger consumer demand, especially for services, while the manufacturing sector is struggling. However, the positive energy shock will likely peter out, while employment expectations have now been falling for two consecutive months. A softening labour market will probably lead to higher savings, while tighter monetary policy in the eurozone will prove to be a strengthening headwind for the economy. In that regard, we still feel comfortable with the expectation of decelerating growth in the second half of the year.

Inflation expectations easing

Lower energy prices, improving supply chains and weaker demand are leading to softening selling price expectations in manufacturing, which have fallen back to the lowest level since January 2021. And while selling price expectations in services remain high, they also fell for the third month in a row. That seems to point to some easing in underlying inflation in the months ahead.

This is the first set of important data released ahead of the May European Central Bank meeting. However, it doesn't look as if the current figures will have made the ECB any wiser about the wider economic picture, which is of an ongoing, though uneven, recovery, with inflationary tensions only slowly subsiding. This begs the question whether a rate hike of 25bp or 50bp will be the most appropriate next week. Based on today's data, we have a small preference for a 25bp hike, but more important data will be published before the meeting of the Governing Council. (Read our ECB preview here.)

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