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WEAKER EUROZONE MOMENTUM TO PERSIST AS PMIS SLIDE FURTHER

Berenberg Macro Flash

Eurozone PMI, November

	Composite	Manufacturing	Services
Actual:	52.4	51.5	53.1
Previous:	53.1	52.0	53.7
Consensus:	53.0	52.0	53.6
Berenberg:	52.9	51.9	53.5

The loss of economic momentum in the Eurozone is proving more pronounced and persistent amid a bigger-than-expected drop of the PMI composite in November to the lowest level in almost four years. The question is what may stop and reverse the trend. For the remainder of 2018, probably not much. The near-term outlook is subdued. Over the course of 2019, however, some of the current headwinds should lose force. That would allow the Eurozone's still encouraging domestic fundamentals to lead the way again.

Domestic economy now almost hit as much as the external sector: The PMI November survey shows that the mostly external shocks are seeping ever more into more restrained domestic demand. While export-reliant manufacturers continue to be hit more by the challenging external environment and are temporarily affected by specific car sector problems, the domestically-oriented service providers in the Eurozone reported a more significant slowdown in activity (from 53.7 in October to 53.1 in November versus 52.0 to 51.5 among manufacturers) for the second month in a row (see chart 1). The PMI survey pointed to both weaker corporate and consumer demand amid "rising political uncertainty, tighter financial conditions and higher prices". Yesterday, the European Commission's gauge for consumer confidence dropped from -2.7 in October to -3.9 in November, the lowest level since March 2017. Sustained market volatility adds to that: the Eurostoxx50 has dropped by almost 4% over the last two weeks. The times of 2018 H1 when consumption and investment were relatively unaffected by what was going on elsewhere are over. Judging by the PMI survey, this is not going to change anytime soon. Forward-looking indicators such as new orders and expectations weakened further in November.

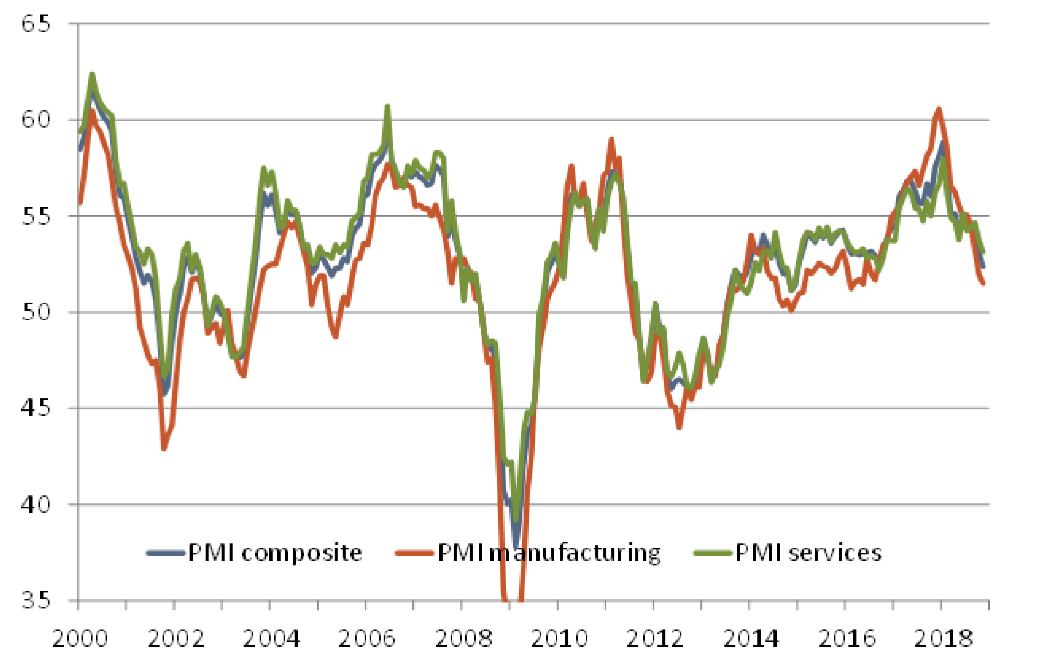
Weak end to 2018: Comparing the quarterly averages highlights the PMI composite's downward trend. After 57.0 in Q1, the PMI composite dropped to 54.7 in Q2, before slipping further to 54.3 in Q3. The average of November and October is at 52.7. This is indicative for a pace of growth of 0.25% qoq in Q4, in line with our forecast, after 0.2% in Q3 and 0.4% qoq in H1. Another setback in December could pose a downside risk to that call. While the PMIs held up in France, in Germany and the rest of the Eurozone they dropped to levels last recorded in 2013.

Expect turnaround over the course of 2019: Since March 2018, a potent cocktail of risks (trade tensions, oil, Italy, Brexit, Turkey, financial market volatility) has slowed down Eurozone growth from a pace well above trend to an annualised rate of around 1% now. On balance, however, we note some signs of hope on key issues that will shape the growth outlook for 2019. First, the global equity sell-off over the recent weeks is unlikely to herald a genuine global economic downturn soon (see How serious is the stock market correction?). Second, domestic fundamentals remain mostly encouraging in the Eurozone with still high capacity utilisation and rising employment. Third, while some negative factors are more persistent than just transitory, we expect some political risks to fade, real disposable incomes to pick-up more strongly at lower oil prices and net exports to be less of a drag. Taken together, chances are that sentiment and demand will rebound over the course of next year. That should propel economic growth slightly above the annualised 1.5% trend rate again from Q2 2019 onwards (see chart 2).

ECB December meeting: Yesterday's account of the ECB Governing Council meeting of late October reiterated Mario Draghi's half-full glass communication, stressing the "underlying strength of the economy". We expect the ECB to send a more dovish signal at its next meeting on 13 December. Softer growth will also cause the ECB to revise its growth projections down and trigger a debate whether the current commitment to keep interest rates at record-low levels should be extended beyond the summer of 2019. The ECB need not take a decision in December already as it still has time to watch the data. As we look for growth to rebound throughout 2019, we maintain our call that the ECB will start to raise rates very gradually next autumn.

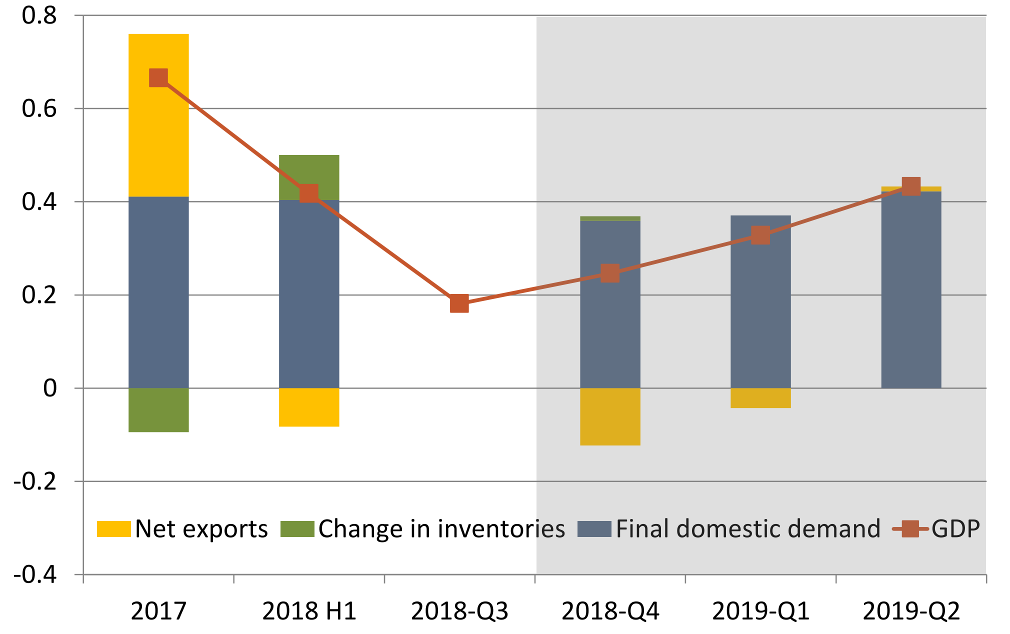
German GDP Q3 data – an odd quarter: A second reading published today confirmed the initial estimate of a 0.2% qoq decline in real GDP in Q3. Temporary problems in the car sector owing to companies' non-compliance to stricter emission requirements and households' reluctance to buy new cars, high oil prices and the fall-out from global trade tensions caused the first quarterly drop in German GDP since Q1 2015. While the German economy is indeed losing some of its late-2017 momentum, the Q3 contraction exaggerates the extent of the underlying slowdown. As car output has started to rebound in October by 22% versus the Q3 average, we look for a snap-back to 0.4% qoq growth in Q4. See our comment on the first reading.

Chart 1: Eurozone PMI composite, manufacturing and services



Source: Markit

Chart 2: GDP growth and its components



Average qoq change of GDP in %. Contributions of GDP components to qoq growth in % points. Berenberg forecast for 2018 Q4 and beyond. Sources: Eurostat, Berenberg

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