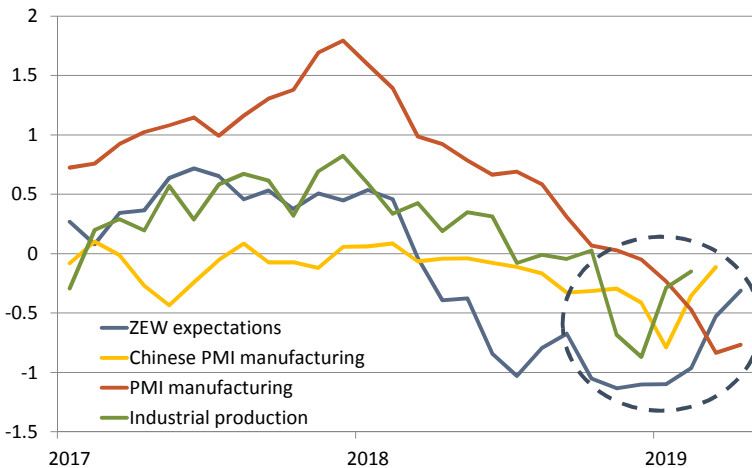


18 April 2019

Eurozone: inflection point ahead?

Mixed signals: Eurozone industrial production and key indicators



Industrial production and key indicators normalised by average and standard deviation since 2005. Sources: ZEW, Caixin, Markit, Eurostat, Haver Analytics, Berenberg.

- Industrial recession close to inflection point?** The export-oriented Eurozone has suffered more than other regions from the global trade slowdown over the past 12 months. Most recent data, such as the 6% fall in export orders for German manufacturing in February, project further weakness ahead. But the newsflow is no longer uniformly bad. While the industrial data could remain volatile, probably with a setback in output in March and April after a rebound in early 2019 from an unusually bad end to 2018, a recovery could start by mid-year.
- Mixed signals:** Today's purchasing managers' index (PMI) for April confirms that Eurozone growth likely remains subdued at the start of Q2. The composite output index fell to a three-month low of 51.3 in April, from 51.6 in March, as a softening in the services PMI from 53.3 to 52.5 more than offset a partial snap-back in manufacturing output to 48.1 from an unusually weak 47.2 in March. While new orders growth picked up slightly, the subindex for new export orders in the composite PMI fell sharply again. All in all, the composite PMI has trended sideways since the start of the year, with some signs that services are softening a little in response to the industrial recession while manufacturing is not deteriorating much further (see chart).
- Progress of sorts:** In line with equity markets, German ZEW expectations of financial analysts and Sentix investor expectations have rebounded this year. This is a necessary but not sufficient condition for a new economic upturn to come. More importantly, the necessary conditions for an industrial turnaround are by and large falling into place. Improving news from China – think GDP, PMI manufacturing and credit – indicate that China's stimulus is starting to work. While losing some momentum and recoupling to the rest of the world upon the fading of its 2018 tax-cut stimulus, US growth remains healthy. In addition, the risk of an [immediate hard Brexit](#) has receded.
- It is very early days:** Despite the turn in the newsflow from bad to mixed, key risks still lie ahead for the Eurozone. US-China trade tensions could blow up again, the Chinese stimulus may run out of breath and Brexit could still end badly. Most importantly, we have to brace ourselves for [noisy US-EU trade talks](#) that could start in earnest once the US and China have defused their dispute. Still, risks to our calls that Eurozone growth will return to normal (annualised growth of 1.5% or slightly more) in H2 2019 are no longer clearly tilted to the downside.
- Any upside potential for markets left?** Near term, Eurozone industry looks set to remain weak. For the outlook from mid-2019 onwards, however, we are more optimistic than consensus. If and when the industrial cycle in the export-oriented Eurozone turns, it could do so noticeably. Some uptick in domestic activity in Europe on top of fading external burdens could see to that. While the Euro Stoxx 50 has recovered by 15% this year already, we think that not all the potential good news is priced in already. As usual, it could still be a bumpy ride, though. The period during which data are mixed rather than mostly good still looks set to last for a few more months.

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