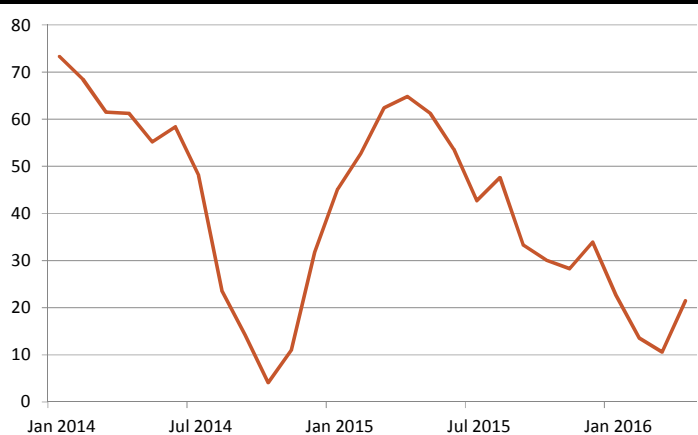


22 April 2016

## Eurozone outlook: first signs of spring?

### Eurozone ZEW expectations: small rebound in April



Outlook for the next six months, balance of optimists and pessimists. Source: ZEW

- **A series of concerns rocked markets in early 2016:** Low oil prices may be bad even for oil-importing countries, China may suffer a hard landing, the crisis in other emerging markets may deepen, the US may fall into recession, and the Eurozone may succumb to deflation amid a worsening banking crisis.
- **One by one, these concerns are being exposed as far overdone:** Oil prices have stabilised at a low level. Meanwhile, the windfall from cheap oil is strengthening consumer balance sheets. As expected, China has unleashed another stimulus to support demand. While simply throwing money at structural problems is not a sustainable solution for China in the long run, it nonetheless looks set to work for the foreseeable future. The end of the rout in raw material prices as well as hopes for a political catharsis in Brazil underpin a less negative outlook for emerging markets. And, despite a weak first quarter in line with similarly restrained starts to the previous years, the US still looks set to enjoy growth close to 2%, supported by healthy consumer incomes.
- **No new banking crisis:** The real news about the European banking system is that Italy is finally starting to tackle its well-known problem of non-performing loans. In addition, the ECB designed its March stimulus package in a most bank-friendly way by mitigating the drag from a more negative deposit rate with a very generous four-year liquidity injection. Credit demand is edging up only very gradually but credit supply is not a major constraint.
- **Beyond the dent to confidence:** The exaggerated concerns of early 2016 had moved overly nervous markets to such an extent that the resulting dent to economic confidence will likely be a short-term drag on demand growth. But the easing of these concerns, the calmer tone in markets and the additional ECB stimulus should start to show up in a rebound of sentiment in the Eurozone within a few months.
- **With a little delay, spring may come soon:** Some of the more forward-looking indicators have started to stabilise or move up. Expectations for the Eurozone in the ZEW survey of financial professionals edged up slightly in April (see chart), while German Ifo expectations had already risen in March. And although the composite purchasing managers' index (PMI) receded slightly further in April to 53.0 from 53.1, the forward-looking component of new orders within that survey improved a little. By and large, the fading of concerns about China and other emerging markets seems to be registering with some companies in the Eurozone.
- **The signs of spring are still very tentative:** While consumer confidence rose slightly from -9.7 in March to -9.3 in April, most indicators of the current situation, such as the headline PMIs for the Eurozone, remain mediocre. Following the dent in leading indicators for the Eurozone earlier this year, we expect growth to decelerate from a respectable quarterly annualised gain of 1.4% in Q1 to no more than 1% in Q2. But the signs of spring in some forward-looking indicators support our call that growth will return to its 1.6% trend rate during the summer.
- **Mind the 35% Brexit risk:** Economic fundamentals paint a modestly encouraging picture. Of course, a Brexit could upset this badly. If the UK votes itself out of its biggest export market, the political repercussions in the UK and the Eurozone could derail the upturn across much of Europe for a while. Let us hope that reason prevails, perhaps helped by a few well-chosen words from US president Barack Obama on his current visit to London.

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