

# The NewsLine

February 21, 2019

▶ MACROECONOMICS | FINANCIAL MARKETS | ECONOMIC POLICY | SECTORS

## EUROZONE

### Weak Q1 confirmed

The PMI indexes suggest that business activity in the Eurozone is expected to remain weak in Q1 2019. Growth should mainly come from the services sector where optimism is growing. This confirms our view that domestic demand should remain resilient in 2019, supported by higher purchasing power and a positive fiscal impulse. Overall, we expect GDP growth to rebound slightly in H2 2019, bringing the annual figure to +1.3%, the first time below potential in four years.

February PMI indexes showed that business activity in the Eurozone remained weak, suggesting GDP will grow by +0.2% q/q at best. For the Eurozone as a whole, the Manufacturing PMI deteriorated further to 49.2 from 50.5 in January, putting it in contractionary territory for the first time since 2013. However, the Services PMI surprised positively as it rebounded to 52.3 from 51.2 in January. Overall, this brought the Composite to 51.4, relatively stable from January.

Composite PMIs in both Germany and France improved slightly, thanks to better prospects in the Services sector in the former and in both the Services and Manufacturing sectors in the latter. The Manufacturing PMI in Germany slipped further into contraction (47.6 from 49.7 in January) on the back of the strongest contraction in six years in export orders, with companies reporting the US-China trade dispute and weakness in the auto sector as main concerns. Elsewhere in the region, output growth continued to slow in both sectors.

In this period of soft landing, corporate buffers are important to look at to see if there is scope for resilience. When looking at (i) turnover growth, it remains at relatively high levels (5% on average), albeit decelerating; (ii) margins are expected to stabilize, thanks to low oil prices and no additional pressures on wages, and (iii) reasonable turnover growth and stable margins should allow for sustainable debt and a continuation in investment plans, even if at a slower

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pace. Hence, business confidence should continue to improve in the coming months, even if there are little chances for it to recover to levels seen in 2018: 55 and 54.5 on average for the Manufacturing and Services sectors, respectively.

Overall, we expect Eurozone growth to remain weak in H1 before slightly rebounding in H2, thanks to three main factors. First, stable inflation, coupled with soft growth, should trigger a dovish bias by the ECB and keep monetary conditions very accommodative. Second, the fiscal impulse should be positive, thanks to higher government spending in Germany, France and Italy. Third, the uncertainty “put” that cut half of a percentage point off Eurozone growth in 2018 should progressively fade away as we expect a resolution to the trade conflict between the US and China, an extension of Article 50 in the UK, which should avoid a disorderly Brexit, no significant escalation in tensions between Italy and the EU and a slight comeback in growth in France, allowing for better household confidence.

In 2019, as a whole, we expect GDP growth at +1.3%, from +1.8% last year.

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