

The NewsLine

April 23, 2018

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EMU

Just an economic soft-patch, not the end of the upswing!

Today's stabilization in eurozone purchasing managers' indices (PMI) is reassuring after recent economic indicators for the region came in below expectations pointing to a marked deceleration in economic momentum. The latter was due to a mixture of exuberant optimism correcting to more reasonable levels, uncertainty about global economic developments and temporary special factors. After a surprisingly weak start to the year, we expect eurozone economic growth to accelerate again. The ECB should see its cautious course justified and not send out any new signals on Thursday.

The eurozone composite purchasing managers' index for industry and services registered at 55.2 points in April, unchanged from the previous month. A further deterioration in the industry survey – the increase in both total orders and new export business was the lowest in a year and a half – was offset by a slight improvement in the service sector survey. Even though economic momentum in the eurozone has clearly cooled since January, on the back of weaker demand as well as supply bottlenecks, the end of the upswing is far from in sight. Evidence for a continued robust development of the eurozone economy can be found, for example, in the renewed acceleration in job creation.

In Germany, the composite index rose to 55.3 points (+0.2) thanks to a slight improvement in the service sector survey and is thus again registering above the long-term average. The indicator for industry, on the other hand, continued to decline slightly to 58.1 points (-0.1), its lowest level since July 2017, with the order intake in April showing the weakest growth in over a year and a half and export order growth falling to a 16-month low. Foreign demand is likely to be

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affected, among other factors, by the strong euro. On the other hand, it was encouraging that employment growth has picked up again, especially in the service sector.

The French purchasing managers' index for industry and services recovered somewhat in April and remains at a high level of 56.9 points (+0.6). The indicator for the service sector was responsible for the improvement of the composite index, while the survey result for the industrial sector fell to a 13-month low. A renewed increase in incoming orders and the still high mountain of orders that have yet to be processed, particularly in the industrial sector, as well as the further upturn in employment growth indicate a sustained robust growth dynamic in the coming months.

Looking back, at the turn of the year sentiment indicators (including those of the EU Commission) reflected marked optimism in the light of positive eurozone economic surprises/forecast revisions. This picture has first been relativized and then further clouded by concerns about an escalation of the trade and/or Syria conflict. Not only sentiment indices but also "hard indicators" such as industrial production and retail sales came in below expectations. Temporary special factors – such as unusually cold weather, the flu epidemic or short-term capacity bottlenecks – are likely to have also played a role.

In our view the eurozone economy is only undergoing a temporary soft-patch. After a GDP growth rate of at best 0.4% in the first quarter of the year, we expect economic momentum to pick-up again – albeit quarterly growth rates of 0.7% achieved in Q2 to Q4 2017 will be out of reach going forward. In addition to today's PMIs, a key factor on which we base our positive growth outlook is the expectation that the ongoing improvement in the labor market will continue. Together with slightly higher wage growth and subdued inflation rates, this provides a good foundation for private consumption which in turn should prop up companies' domestic sales prospects and investment incentives. All in all, we see little evidence for a marked economic growth setback, but are instead sticking to our GDP growth forecast of 2.3% for 2018. However, downside risks are currently rising and their development must be monitored closely.

In view of the fact that most of the EMU economic indicators are currently declining but remain at a comfortable level, no significant change in communication is to be expected at the ECB press conference on Thursday. The ECB will remain confident about growth prospects in the eurozone, while at the same time considering the inflation outlook not yet sufficiently secure.

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