

Eurozone Chartbook

Slippery growth seeks fiscal support

Economics/Growth/Monetary/Fiscal

Group Research

10 October 2019

Radhika Rao

Economist

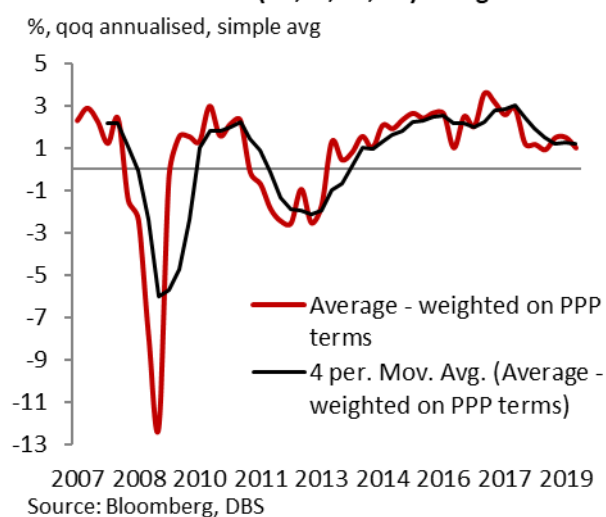


Please direct distribution queries to

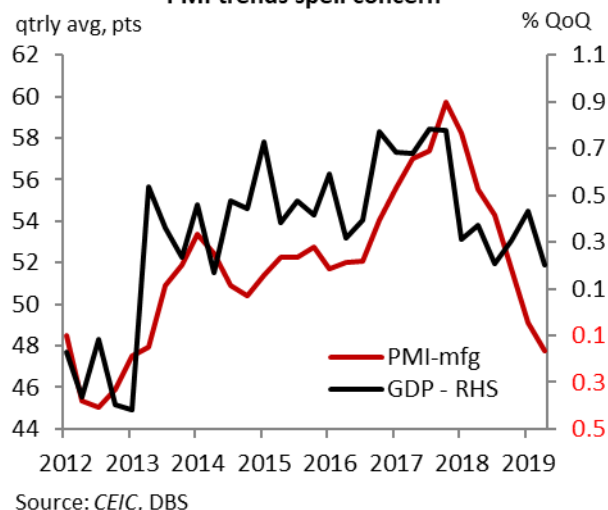
Violet Lee +65 68785281 violetheeh@db.com

- High-frequency data continue to weaken, led by sluggish trade and manufacturing activity
- Germany is at the cusp of a technical recession in 3Q19, hurt by a tough global environment and structural weakness in key sectors
- We trim 2019 and 2020 Eurozone growth forecasts
- The European Central Bank was ahead-of-the-curve to ease policy and more is likely as external risks (Brexit, trade wars etc.) are eyed. New ECB Chief takes over in November
- Impact of policy easing is evident in a weak currency, but does little for real activity
- Push for fiscal policy to take a growth-supportive stance is rising
- Restart of asset purchases bode well for Eurozone bond yields
- EUR is expected to weaken vs the USD

Eurozone: Core 4 (GE, IT, SP, FR) GDP growth



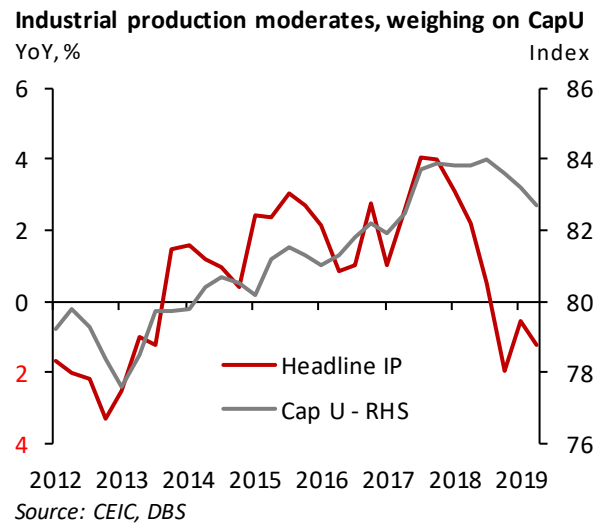
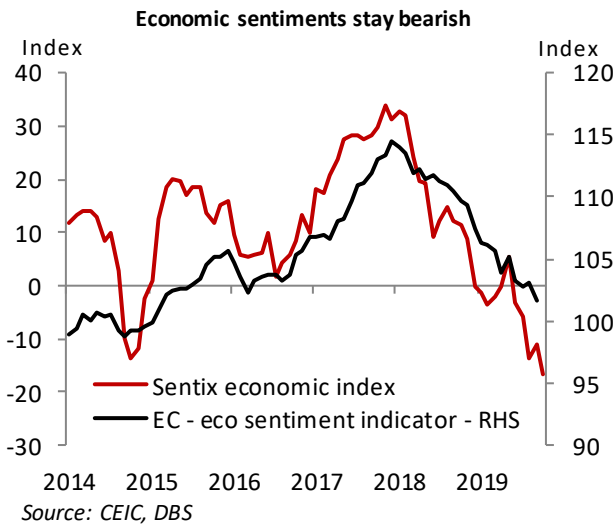
PMI trends spell concern



Real activity indicators weaken

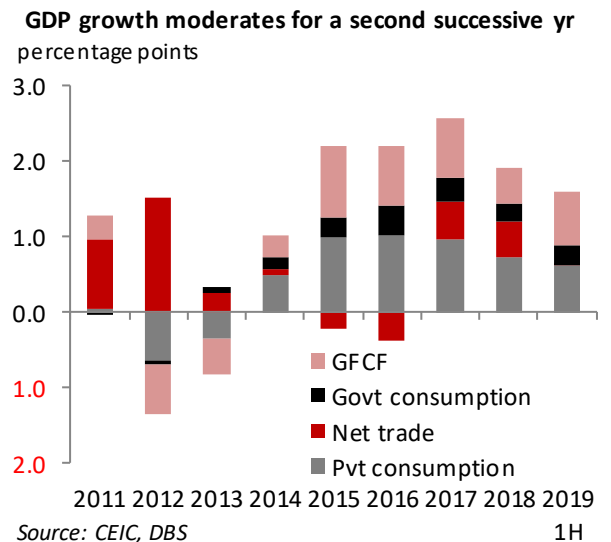
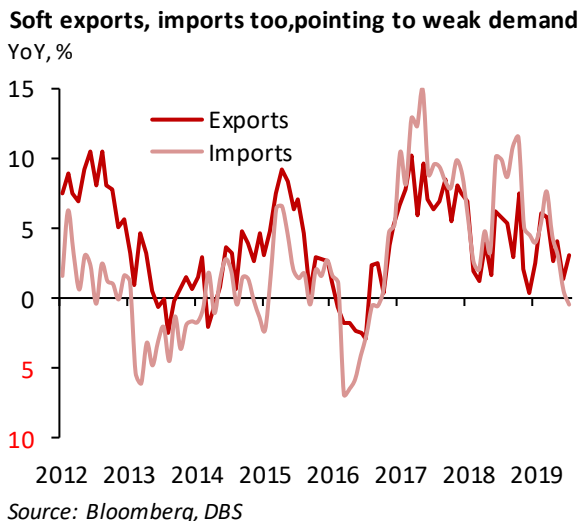
Sentiments have weakened into 3Q over worries that a challenging global environment and slowing manufacturing activity will spill over to consumption demand and wage growth

Manufacturing production has decline, along with a pullback in capacity utilisation. Slowdown has been broad-based, including utilities, mining, intermediate goods and consumer durables



Exports have been slowing since 2018, with the pace accelerating this year. Impact on the net trade balance, however, has been contained as imports have also moderated. Contribution from net trade is likely to flat this year

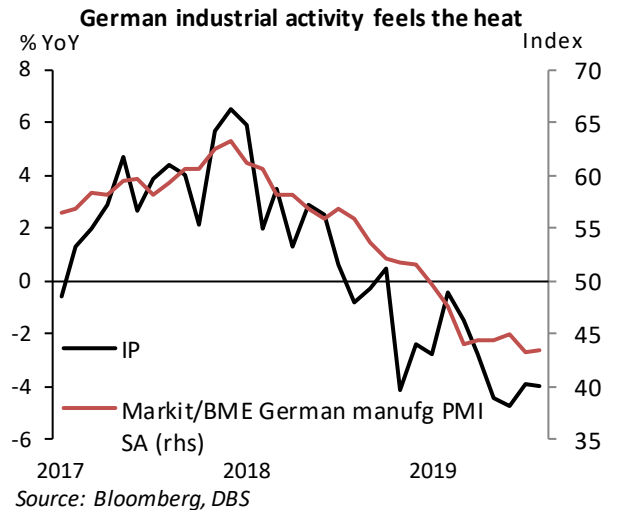
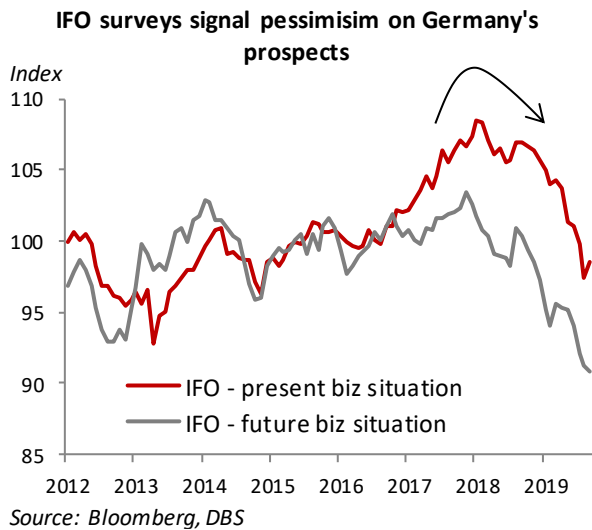
Domestic demand is faring better but spillover from weak manufacturing and exports is a concern. Inventory drawdown has weighed on growth. Considering domestic and external risks, we trim 2019 GDP to 1% (vs 1.2% earlier) and 2020 to 1.1%



Germany heads towards a recession

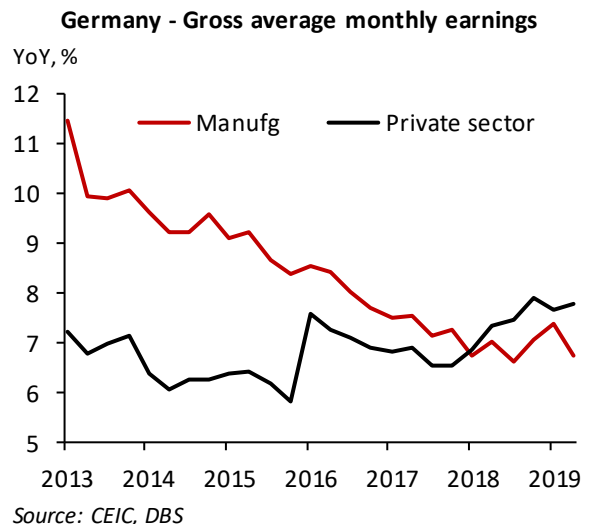
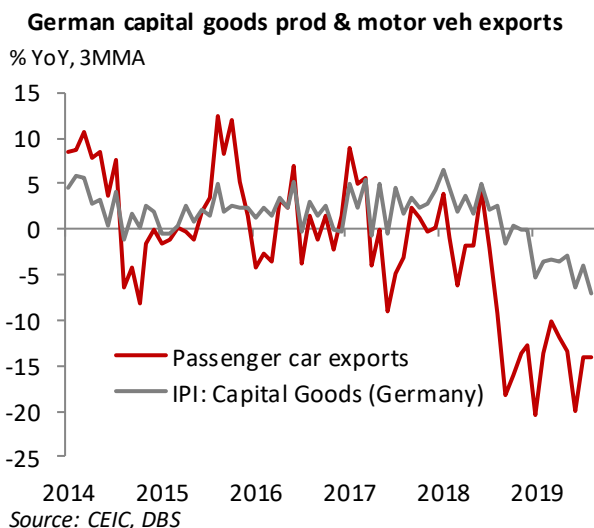
Business confidence in Germany remains pessimistic, with the IFO survey signalling concerns over near-term and future business conditions. Export order indices have continued to deteriorate

Activity has tracked sentiments. Sluggish manufacturing PMIs are also rubbing off on services activity. Risks of a technical recession in 3Q has risen vs -0.1% QoQ fall in 2Q



German auto exports have slumped in recent months, with the drop no longer a one-off contraction as structural headwinds surface. With over two-thirds of automotive exported, this has adversely impacted production patterns

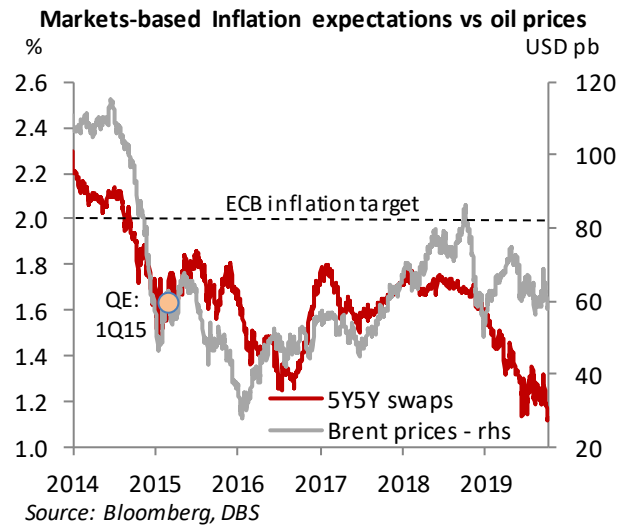
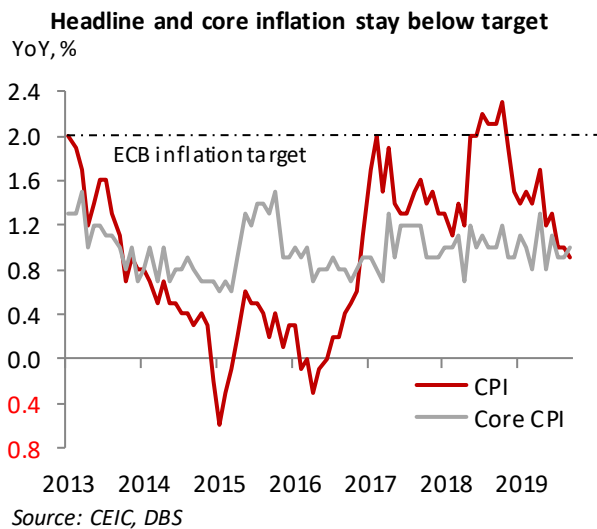
Wage growth for the private sector held up well by 1H19, but manufacturing sector has slowed. This reflects tougher times for the sector, which if persistent will impact the wider economy



Benign inflation outlook

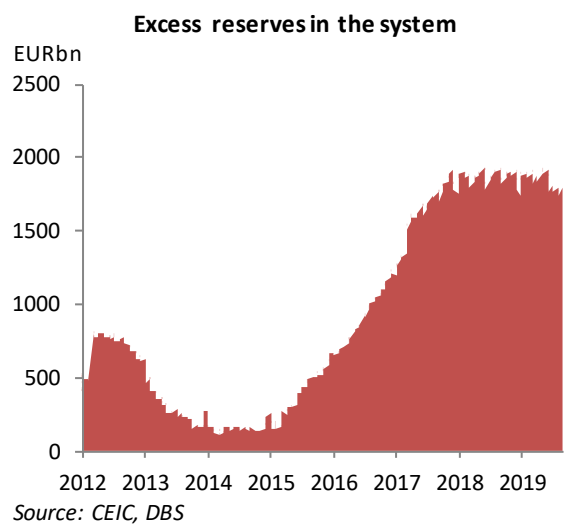
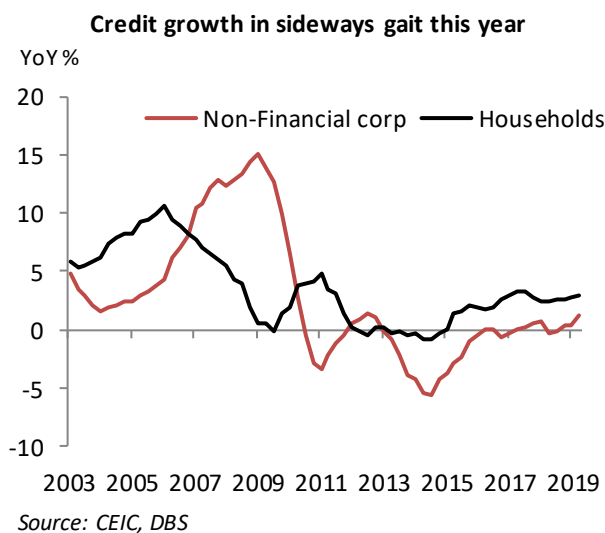
Inflation remains benign, with year-to-date average at 1.3% vs 2% ECB target. Price pressures have been subdued and sub-target since 2013. Weakening core readings also reinforce expectations of softening domestic demand

Notwithstanding intermittent supply shocks, inflationary expectations have continued to slip, reflecting markets' doubts over the ability of monetary policy to revive price pressures



Credit growth benefited liquidity supply from rates near zero and asset purchases since 2015. Both households and non-financial corp loans have risen in the past two-three years before settling into a range this year.

Excess reserves have risen sharply in past few years owing to QE and together with negative rates, have led banks to pay for some of their excess cash parked at the ECB. To correct this, a tiered facility has been introduced

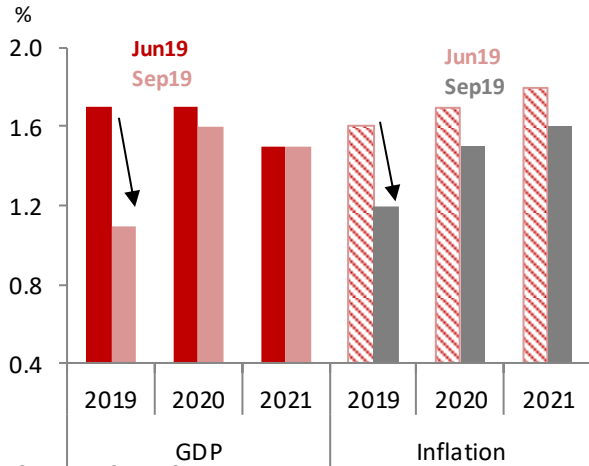


Monetary policy turns dovish

Following dovish signals in June, the ECB lowered inflation and growth projections in September. Inflation is seen below target at least for the next 3 years, with external risks weighing on GDP

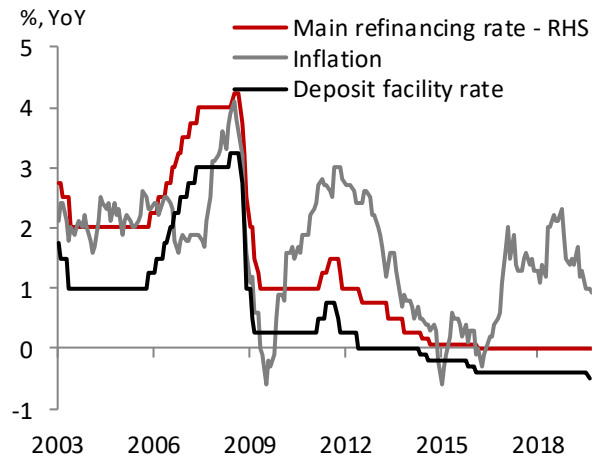
Forecast revisions were accompanied by a) 10bps cut in the deposit facility rate to -0.5%, b) dovish guidance, c) restart of the QE program; d) cheap financing program unveiled earlier in the year

ECB staff projections - Growth and inflation lowered



Source: ECB, DBS

Inflation vs benchmark rate

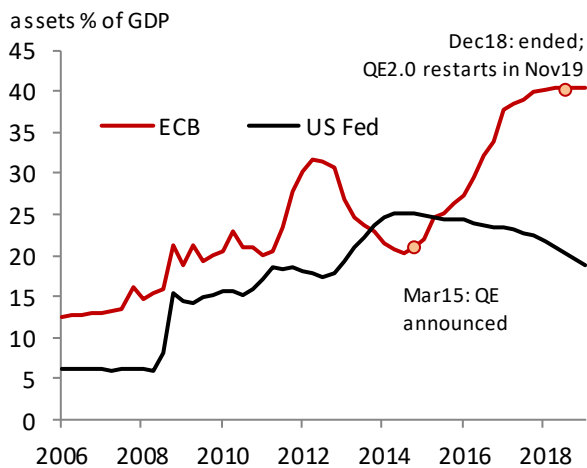


Source: CEIC, DBS

Less than nine months since QE was withdrawn in late-2018, ECB plans to resume EUR20bn/ month asset purchases from November. This will lift ECB B/S back above 40% of GDP into 2020. Markets price in one more rate cut this year

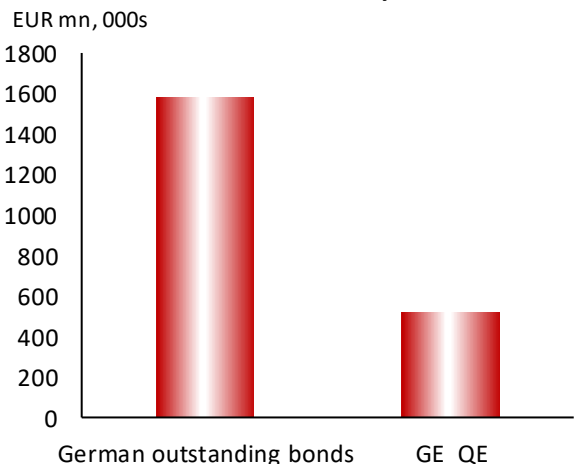
QE 2.0 unveiled in September was left open-ended. Without any changes in the underlying thresholds, especially the 33% cap on member country bonds, a review is likely within a year

US Fed vs ECB Balance sheet



Source: Bloomberg DBS

ECB QE: Germany

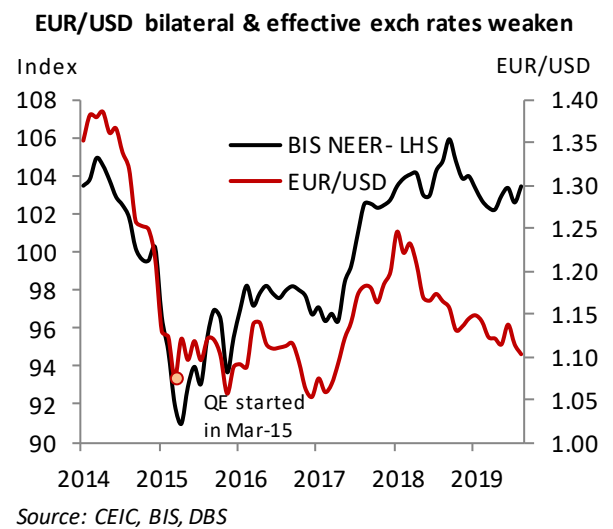
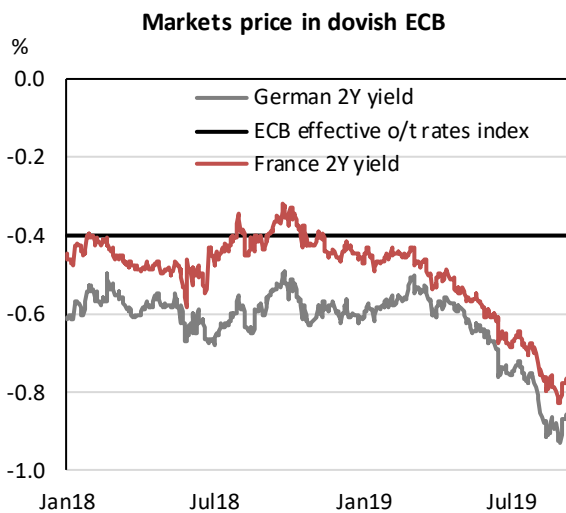


Source: ECB, DBS

Fiscal policy needs to turn supportive

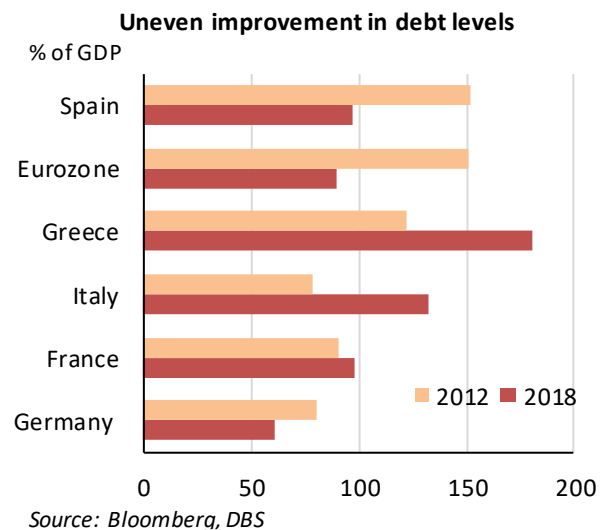
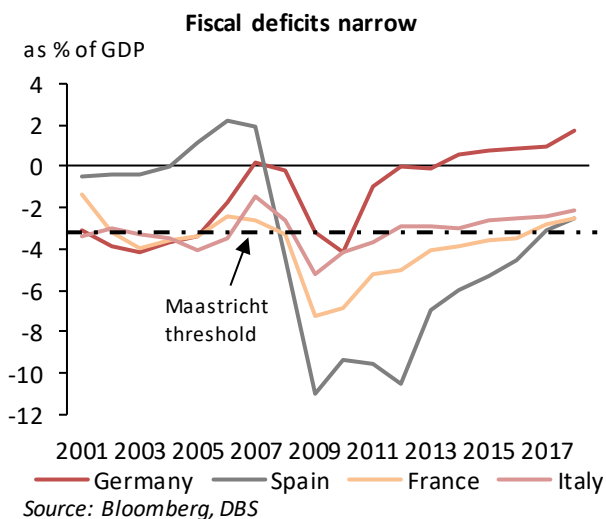
Monetary policy is likely to remain supportive into 2020. Impact of the easy monetary policy is most telling in the markets, rather than the real economy. Yields have dipped into negative, hurting savers and weakening bank profitability.

EUR/USD declined this year, adding to last year's depreciation. This has improved competitiveness at the margin, albeit a smaller extent of decline in the REER/NEER highlights that currencies of trading partners have also eased in concert



Pressure to support growth will shift to fiscal policy. Encouragingly, fiscal balances of core countries have improved since the 2012 crisis. Fiscal deficits have narrowed, while Germany has widened its net surplus in the past five years

Room for fiscal stimulus varies between member countries. Govt debt levels have improved in aggregate Eurozone, led by Spain and Germany. Italy's are higher vs 2012, troubled by slow growth, political troubles and weak revenues



Group Research

Economics & Macro Strategy

Taimur Baig, Ph.D.

Chief Economist - G3 & Asia

+65 6878-9548 taimurbaig@dbs.com

Chang Wei Liang

Strategist

+65 6878-2072 weiliangchang@dbs.com

Ma Tieying, CFA

Economist - Japan, South Korea, & Taiwan

+65 6878-2408 matieying@dbs.com

Nathan Chow

Strategist - China & Hong Kong

+852 3668-5693 nathanchow@dbs.com

Radhika Rao

Economist – Eurozone, India, & Thailand

+65 6878-5282 radhikarao@dbs.com

Masyita Crystallin, Ph.D.

Economist – Indonesia & Philippines

+62 21-2988-4003 masyita@dbs.com

Irvin Seah

Economist - Singapore, Malaysia, & Vietnam

+65 6878-6727 irvinseah@dbs.com

Joanne Goh

Regional equity strategist

+65 6878-5233 joannegohsc@dbs.com

Samuel Tse

Economist - China & Hong Kong

+852 3668-5694 samueltse@dbs.com

Eugene Leow

Rates Strategist - G3 & Asia

+65 6878-2842 eugeneleow@dbs.com

Duncan Tan

FX and Rates Strategist - Asean

+65 6878-2140 duncantan@dbs.com

Chris Leung

Economist - China & Hong Kong

+852 3668-5694 chrisleung@dbs.com

Philip Wee

FX Strategist - G3 & Asia

+65 6878-4033 philipwee@dbs.com

Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

Disclaimer:

The information herein is published by DBS Bank Ltd and PT Bank DBS Indonesia (collectively, the "DBS Group"). It is based on information obtained from sources believed to be reliable, but the Group does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. Opinions expressed are subject to change without notice. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation & the particular needs of any specific addressee. The information herein is published for the information of addressees only & is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. The Group, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Group or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Group & its associates, their directors, officers and/or employees may have positions or other interests in, & may effect transactions in securities mentioned herein & may also perform or seek to perform broking, investment banking & other banking or financial services for these companies. The information herein is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation. Sources for all charts & tables are CEIC & Bloomberg unless otherwise specified.

DBS Bank Ltd., 12 Marina Blvd, Marina Bay Financial Center Tower 3, Singapore 018982. Tel: 65-6878-8888. Company Registration No. 196800306E. PT Bank DBS Indonesia, DBS Bank Tower, 33rd floor, Ciputra World 1, Jalan Prof. Dr. Satrio Kav 3-5, Jakarta, 12940, Indonesia. Tel: 62-21-2988-4000. Company Registration No. 09.03.1.64.96422.