Economics

Eurozone Chartbook

Slippery growth seeks fiscal support

Economics/Growth/Monetary/Fiscal

Group Research

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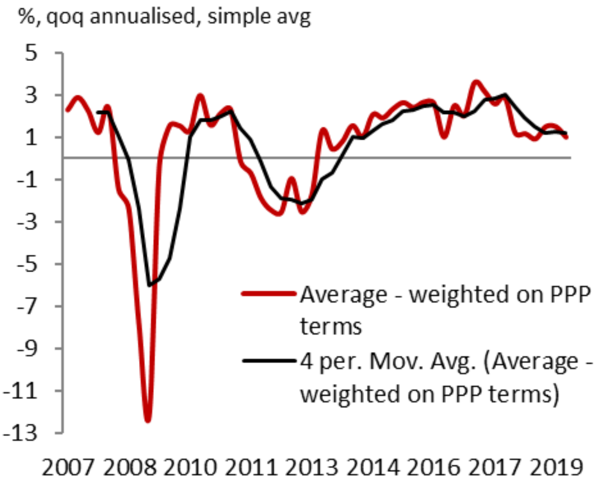
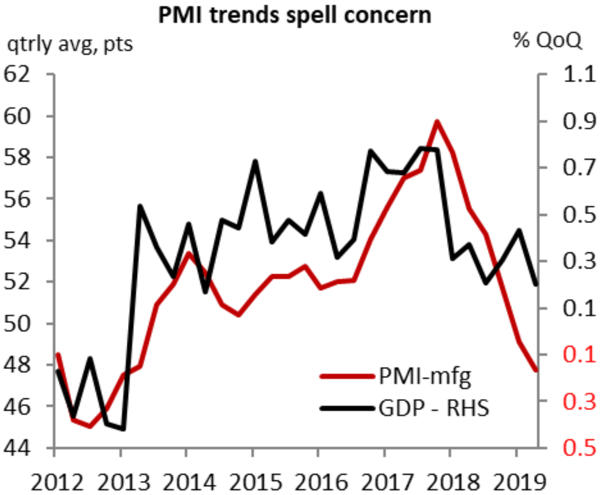
- *High-frequency data continue to weaken, led by sluggish trade and manufacturing activity*
- *Germany is at the cusp of a technical recession in 3Q19, hurt by a tough global environment and structural weakness in key sectors*
- *We trim 2019 and 2020 Eurozone growth forecasts*
- *The European Central 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



Source: Bloomberg, DBS

PMI trends spell concern



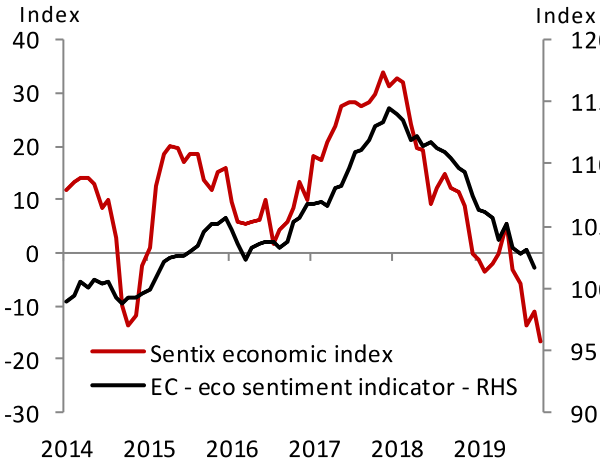
Source: *CEIC*, DBS

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

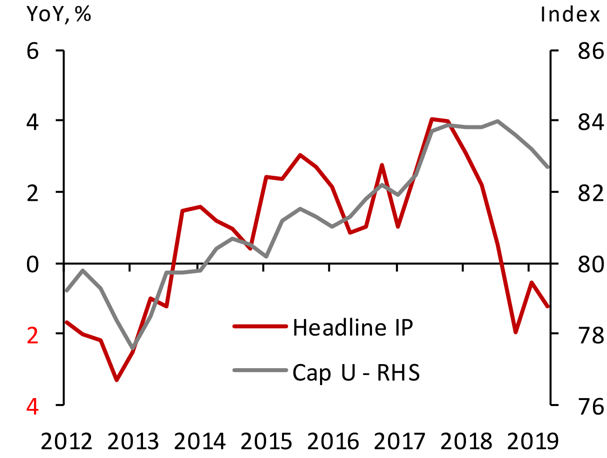
Manufacturing production has decline, along with a pullback in capacity utilisation. Slowdown has been broad-based, including utilities, mining, intermediate goods and consumer durables

Economic sentiments stay bearish



Source: CEIC, DBS

Industrial production moderates, weighing on CapU

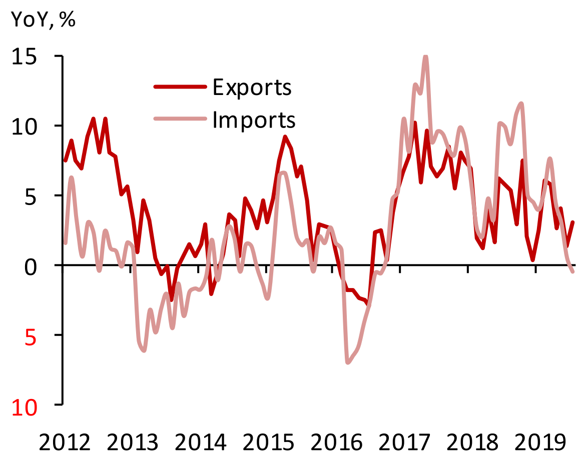


Source: CEIC, DBS

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

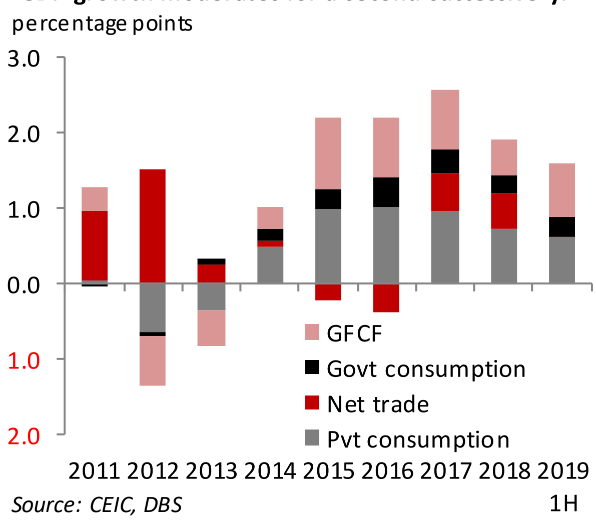
Domestic demand is faring better but spillover from weak manufacturing and exports is a concern. Inventory drawdown has weighed on growth. Considering domestic and external risks, we trim 2019 GDP to 1% (vs 1.2% earlier) and 2020 to 1.1%

Soft exports, imports too,pointing to weak demand



Source: Bloomberg, DBS

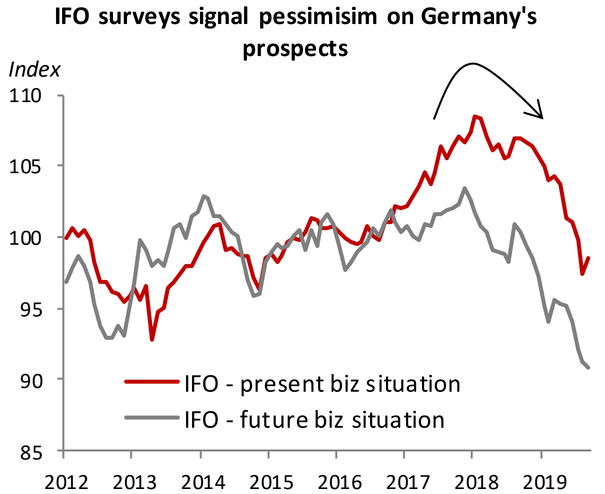
GDP growth moderates for a second successive yr



Source: CEIC, DBS

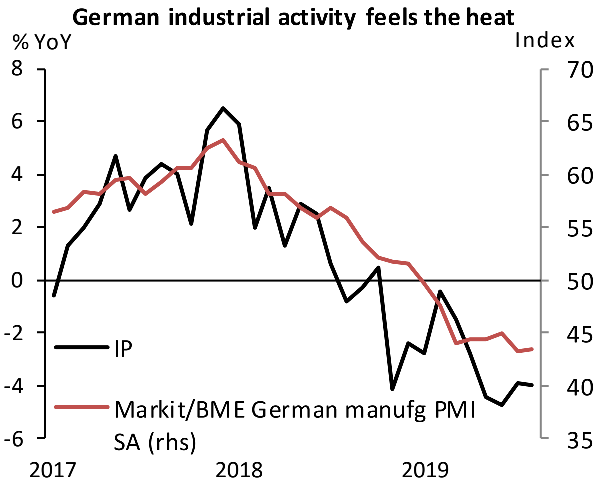
Germany heads towards a recession

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



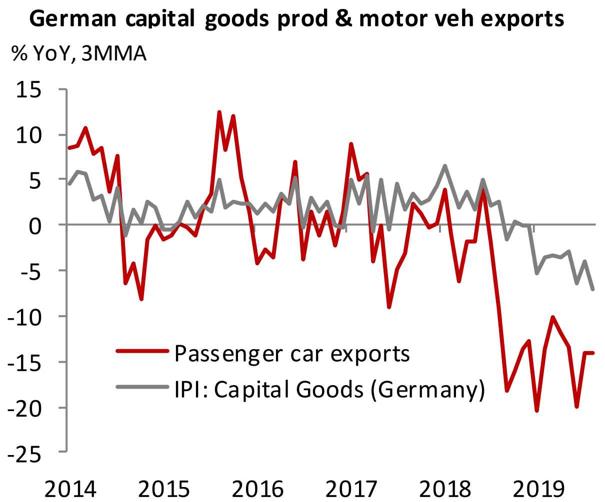
Source: Bloomberg, DBS

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



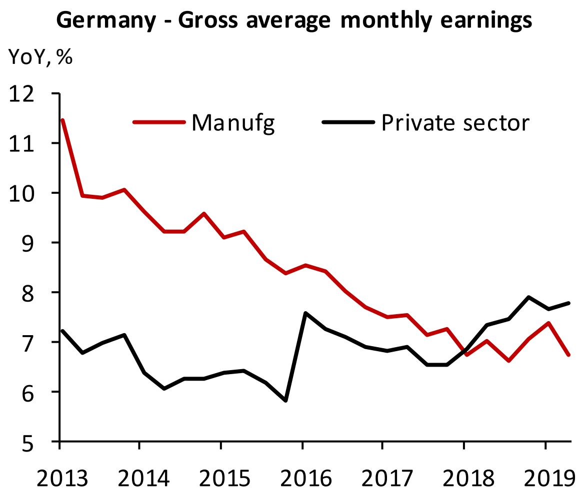
Source: Bloomberg, DBS

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



Source: CEIC, DBS

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

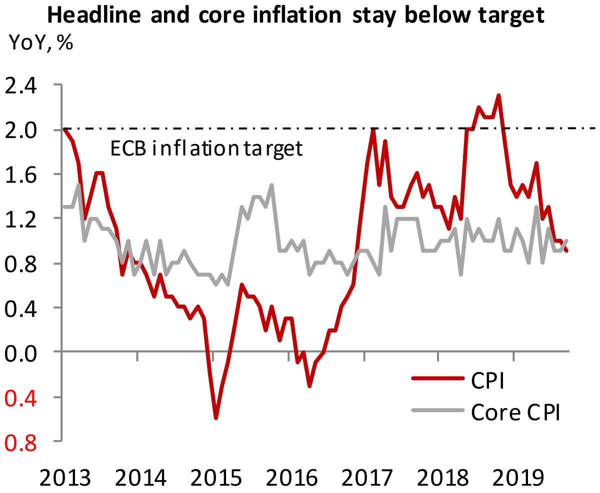


Source: CEIC, DBS

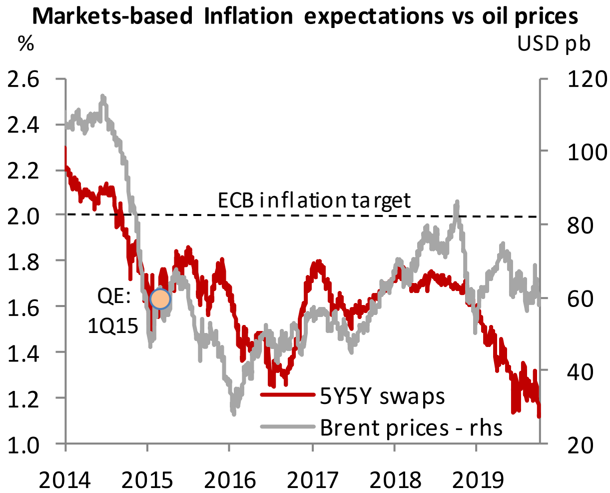
Benign inflation outlook

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



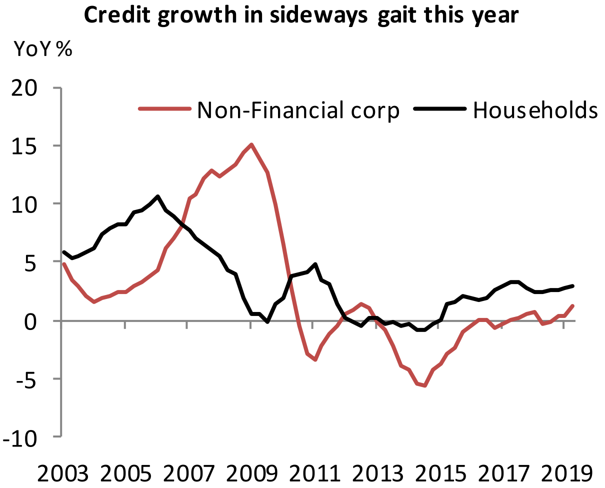
Source: CEIC, DBS



Source: Bloomberg, DBS

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



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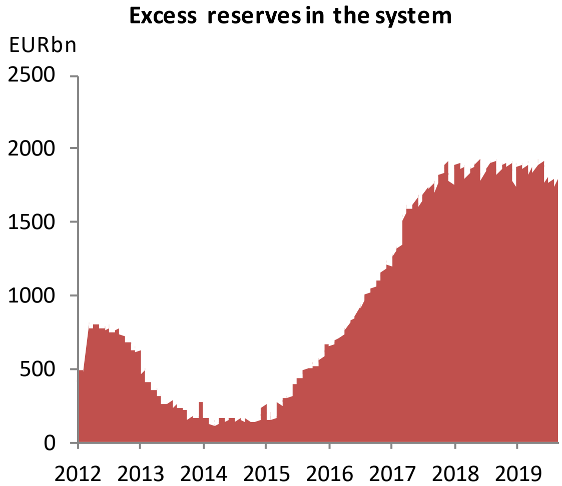


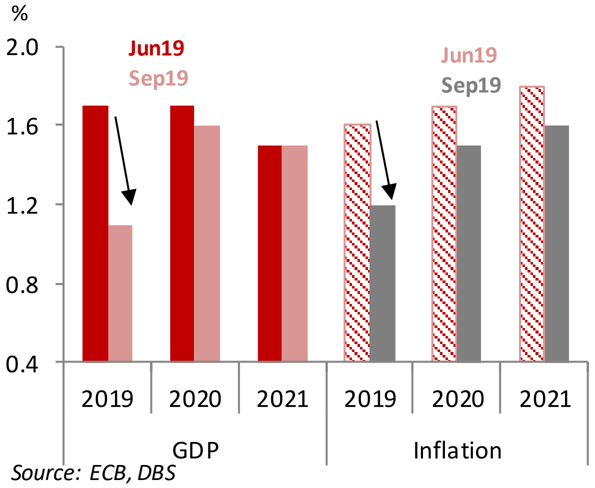
Source: CEIC, DBS

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 3years, with external risks weighing on GDP

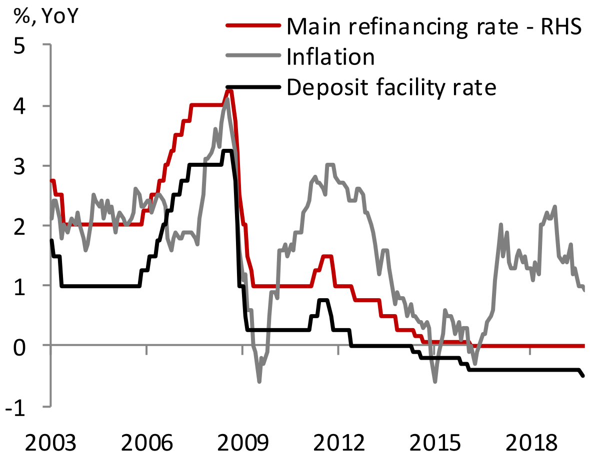
Forecast revisions were accompanied by a) 10bps cut in the deposit facility rate to -0.5%, b) dovish guidance, c) restart of the QE program; d) cheap financing program unveiled earlier in the year

ECB staff projections - Growth and inflation lowered



Source: ECB, DBS

Inflation vs benchmark rate

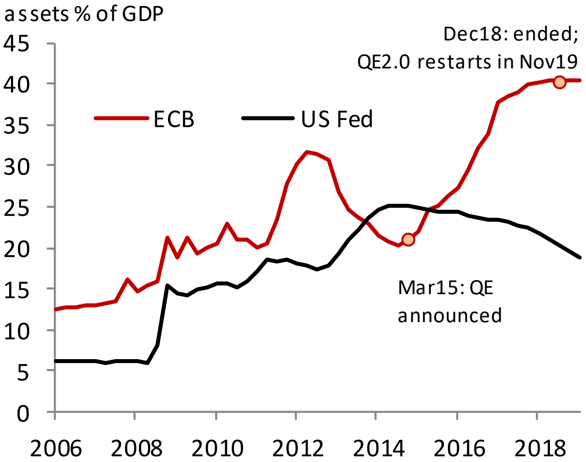


Source: CEIC, DBS

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

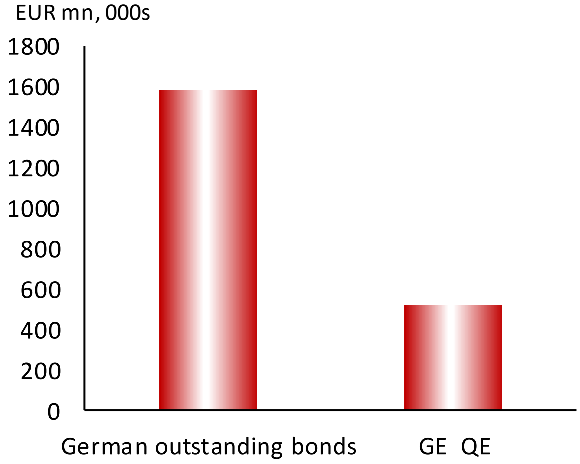
QE 2.0 unveiled in September was left open-ended. Without any changes in the underlying thresholds, especially the 33% cap on member country bonds, a review is likely within a year

US Fed vs ECB Balance sheet



Source: Bloomberg, DBS

ECB QE: Germany

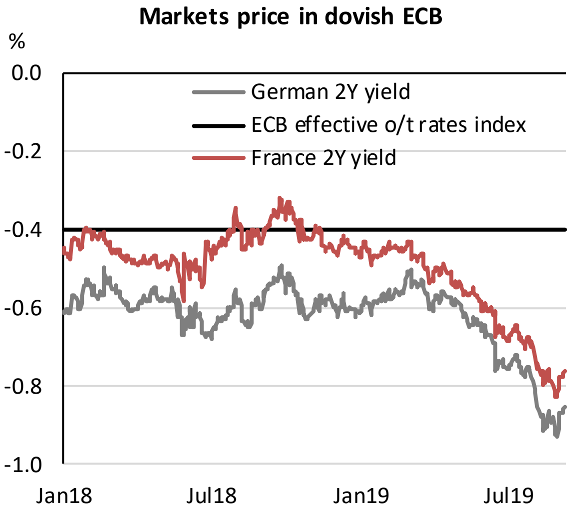


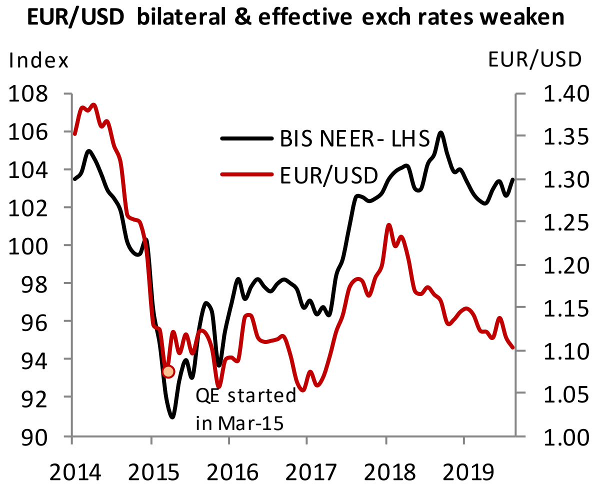
Source: ECB, DBS

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

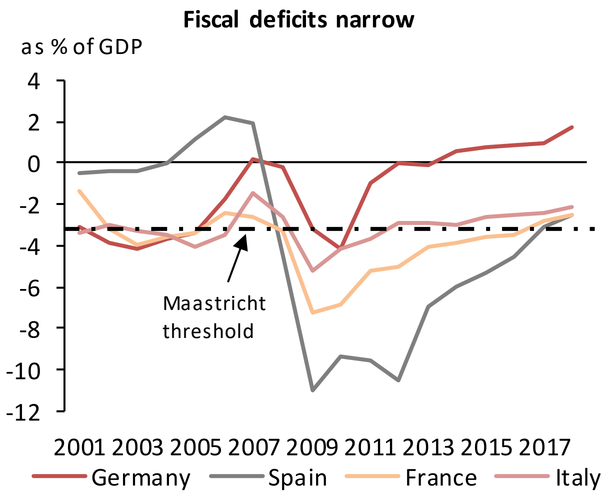




Source: CEIC, BIS, DBS

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



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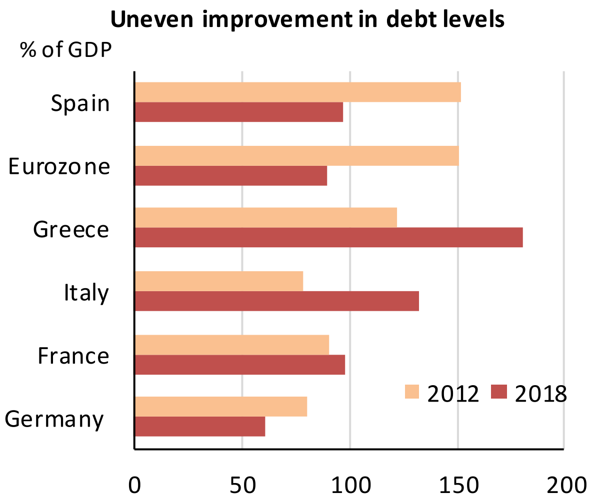

Source: Bloomberg, DBS

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