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Eurozone: Cooler sentiment

■ Sentiment indicators continue their softening trend and the flash estimate points towards weak third quarter GDP growth ■ Yet drivers of final demand continue to point towards ongoing good growth in the upcoming quarters ■ Data in the coming weeks as well as developments concerning Brexit and US trade policy will be key to confirm or tune down this assessment

Faced with increased uncertainty, it is tempting to feel nostalgic. This is very much the case when comparing the latest purchasing managers heatmap with the results early this year. Back then it was red across the board, for all countries, both manufacturing and services. Red corresponds to robust growth. Today we have various shades of red, more so in manufacturing than services, and even some blue (in Italy). Other survey-based indicators paint a similar picture: the European Commission's economic sentiment index for the eurozone (although it is still at a high level) or the IFO economic expectations indicator for the eurozone, which is now back to a level last seen at the end of 2012. The preliminary flash estimate showed third quarter GDP growth of a mere +0.2% versus the previous quarter (non-annualised), after growing at 0.4% both in the first and second quarter. Year-over-year growth slowed from 2.2% in Q2 to 1.7%, still above potential but clearly less than before. Ad hoc factors have played a role (e.g. in the automobile sector due to changes in test procedures - WLTP), as well as trade war related uncertainty, rising oil prices and financial market volatility.

MARKIT PMI HEATMAP

	Manufacturing								Services					
	EURO ZONE	AUSTRIA	FRANCE	GERMANY	IRELAND	ITALY	NETHERLANDS	SPAIN	EURO ZONE	FRANCE	GERMANY	IRELAND	ITALY	SPAIN
Dec-17	60.6	64.3	58.8	63.3	59.1	57.4	62.2	55.8	56.6	59.1	55.8	60.4	55.4	54.6
Jan-18	59.6	61.3	58.4	61.1	57.6	59.0	62.5	55.2	58.0	59.2	57.3	59.8	57.7	56.9
Feb-18	58.6	59.2	55.9	60.6	56.2	56.8	63.4	56.0	56.2	57.4	55.3	57.2	55.0	57.3
Mar-18	56.6	58.0	53.7	58.2	54.1	55.1	61.5	54.8	54.9	56.9	53.9	56.5	52.6	56.2
Apr-18	56.2	58.0	53.8	58.1	55.3	53.5	60.7	54.4	54.7	57.4	53.0	58.4	52.6	55.6
May-18	55.5	57.3	54.4	56.9	55.4	52.7	60.3	53.4	53.8	54.3	52.1	59.3	53.1	56.4
Jun-18	54.9	56.6	52.5	55.9	56.6	53.3	60.1	53.4	55.2	55.9	54.5	59.5	54.3	55.4
Jul-18	55.1	56.8	53.3	56.9	56.3	51.5	58.0	52.9	54.2	54.9	54.1	57.4	54.0	52.6
Aug-18	54.6	56.4	53.5	55.9	57.5	50.1	59.1	53.0	54.4	55.4	55.0	58.0	52.6	52.7
Sep-18	53.2	55.0	52.5	53.7	56.3	50.0	59.8	51.4	54.7	54.8	55.9	58.7	53.3	52.5
Oct-18	52.0	53.8	51.2	52.2	54.9	49.2	57.1	51.8	53.7	55.3	54.7	57.2	49.2	54.0

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Source: Markit PMI, BNP Paribas

Of course, these indicators are only snapshots which don't tell us how the economic movie will continue. Looking at the drivers of demand, the monetary and financial environment will remain very accomodative and the prospect of the ECB stopping its net asset purchases at the end of this year won't change this. The past weakening of the euro should, with some delay, help exports but this is small comfort giving the loss in the terms of trade due to a bigger weight of the dollar in eurozone imports. Household income growth should be supported by a declining unemployment rate and accelerating growth in compensation. Consensus estimates of profits of listed companies point towards an increase for the coming 12 months of about 10 percent which should support corporate investment. World trade growth has now stabilised on a year-over-year basis, albeit at a lower level than in 2017. So all in all, conditions seem to be in place for ongoing growth, less than in the first half of 2018 but still good. At his latest press conference, Mario Draghi characterised it as a loss of momentum, not a downturn. A fair assessment, yet the softer sentiment readings as of late imply that the data in the coming weeks, and indeed the updated ECB staff forecasts in December, will be eagerly awaited. The same applies to news on the Brexit negotiations and to US trade policy.

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