THE EUROZONE ECONOMIC MONITOR

FEBRUARY 21, 2019
CLAUS VISTESEN, CHIEF EUROZONE ECONOMIST

We are betting on a rebound in the French services index to lift the headline Eurozone PMI today.

Leading indicators for EZ manufacturing and exports still look weak; the January hard data will be poor.

Mean reversion is a powerful force in the data, and it now points to a rebound in the EZ surveys.

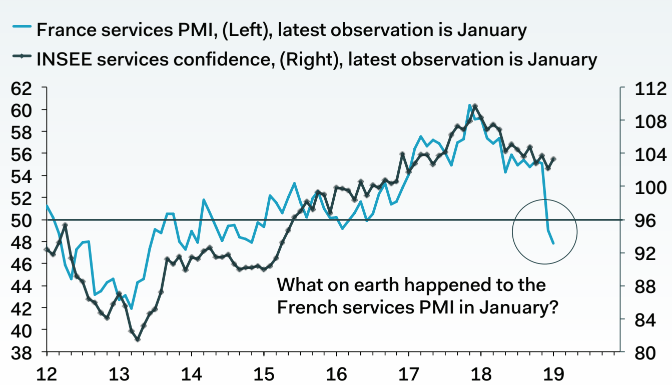
Will the Real Story in French Services Please Stand Up

Today's data dump will deliver the advance PMIs and the French INSEE business sentiment indices for February, all of which will be examined closely for signs of stabilisation in the wake of recent evidence that EZ growth is slowing quicker than markets and the ECB have been expecting. ***Anything can happen in a given month, but we are hoping for evidence that the recent free fall, mainly in the PMIs, is over.***

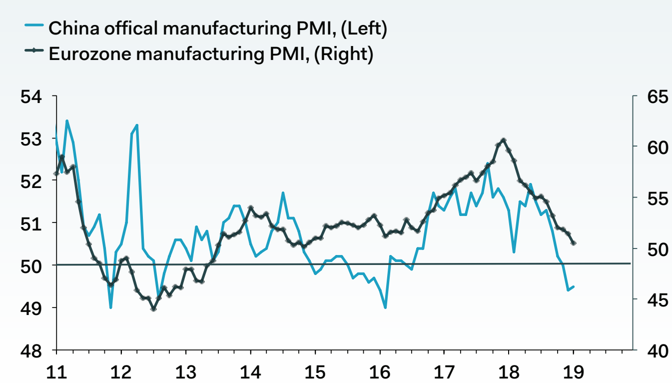
The French services data are front and centre in today's reports, and we are betting on a rebound in the PMI. Our first chart shows that the collapse in December and January was wildly at odds with the national INSEE data. Either of the two could be wrong, but the strong performance of services capex in Q4 suggests that the PMI is overplaying the weakness. We suspect that the divergence is down to respondents to Markit's survey overplaying the hit to activity from the "Yellow Vests" protests. Differences in the sampling and timing of the two surveys probably also have been factors, but in truth we aren't entirely sure why the PMI has come crashing down What we are fairly certain about, however, is that conditions for the French consumer are now improving. Tax cuts, a higher minimum wage and a big reduction in headline inflation provided strong tailwinds at the start of the year. *In total, we think the composite EZ PMI edged higher in February, to 51.5 from 51.0 in January, thanks mainly to a recovery in the French services data.*

Elsewhere, leading indicators for EZ manufacturing still look soggy. We think the French INSEE headline was unchanged at 103 in February, but our next chart shows that the official Chinese PMI has plunged deep into contraction territory, warning about further downside for the EZ as a whole. Other data out of China have been equally poor at the start of the year. Growth in trade volumes has collapsed, car sales are falling off a cliff and domestic liquidity indicators are still heading lower. These weak headlines were confirmed on Tuesday by a plunge in Japanese exports, which is another key bellwether for the global manufacturing sector. As a result, we have to assume the January data in the Eurozone, especially in the export sector, will be grim.

ALL EYES ON THE FRENCH SERVICES PMI TODAY



HOW MUCH FURTHER DOWNSIDE FOR THE EZ MANUFACTURING PMI?



The PBoC has thrown the kitchen sink at the economy, pointing to a rebound at some point in the first half of the year, but we also see signs that the marginal returns of monetary stimulus are waning. In addition, the Chinese data will be difficult to read in coming months due to the seasonality issues around the New Year celebrations. We don't expect clarity until early spring.

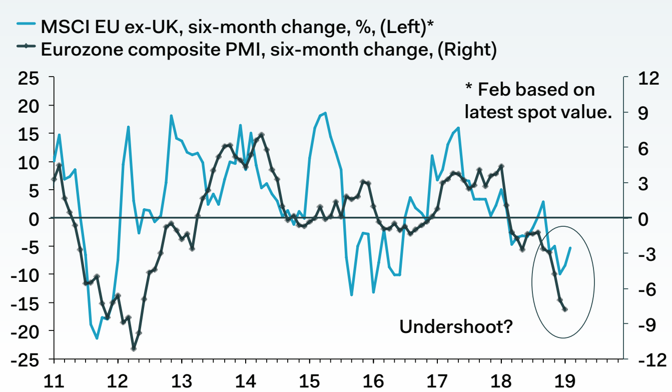
Meanwhile, the slowdown in China is steadily infecting manufacturing data across the globe, and the Eurozone usually is first in line when the global industrial cycle is rolling over. During the 2016 devaluation scare, the EZ manufacturing PMI remained resilient in the face of the slide in China, but with the German and Italian indices already below 50, the risk of further weakness in the euro area index is still high.

Counting on mean reversion to lift EZ surveys

Looking beyond our optimistic take on today's data, mean reversion is beginning to favour a bet on stabilisation, if not an outright rebound, in the main EZ surveys. The composite PMI in the Eurozone is now falling at the same pace as it did during the sovereign debt crisis in 2011 and 2012. The same is the case for the German IFO expectations index. Declines of this magnitude look overdone, given that neither economic nor financial conditions are anywhere near as grave as they were then, at least not in the domestic economy.

The free fall in these surveys also is increasingly at odds with strength in financial markets at the start of the year. Our next chart shows that the six-month change in the PMI is still plunging, in contrast to the six-month change in equities, which is turning up, albeit modestly.

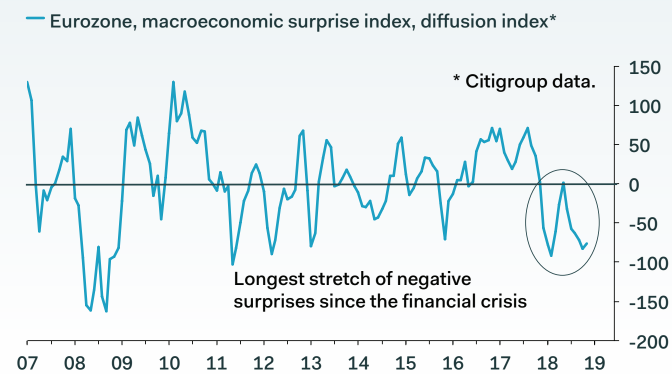
MEAN REVERSION IS LOOKING GOOD FOR A REBOUND IN THE PMIS



This divergence does not guarantee a rebound in the surveys, but it supports the call for stabilisation, at least.

The trend in macroeconomic surprise indices tells a similar story. Our final chart shows that Citigroup's index for EZ data surprises has collapsed, *again*, after briefly moving above zero at the end of Q3. The recent stretch of negative surprises is now on par with the decline during the financial crisis. This indicates that it won't take much in the way of upside in the data to drive market expectations higher. A year ago, the consensus was celebrating EZ PMI data above 60 and the prospect of 3% GDP growth through 2018. These expectations were always too high, and in similar fashion, we think the current depression is overplaying the extent to which the euro area economy is weakening.

A VERY LOW BASE FOR SOME POSITIVE SURPRISES IN THE EZ



Down a nudge for German and French inflation

The final two economic reports today will confirm that headline inflation in Germany and France fell sharply last month, to 1.4% and 1.2% respectively, thanks to lower energy inflation. The trend in oil prices suggests that the energy components will remain stable in coming months, before falling further through the summer. Elsewhere, the core rates should remain resilient. Services inflation likely is rising slowly as a lagged response to higher wage growth, but non-energy goods inflation is going nowhere, and risks are now tilted to the downside, thanks to the deceleration in Chinese producer price inflation.

CLAUS VISTESEN **+44 191 2600 308**
claus@pantheonmacro.com Twitter: @ClausVistesen

THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, February 18

- **No significant data released**

Tuesday, February 19

- **D: Current Account, Eurozone (12) 10:00 CET**

The headline current account surplus fell to **€16.2B** in December, from a revised €22.6B in November, hit by a drop in the trade surplus, which offset modest gains in net services and income.

- **D: ZEW, Germany (2) 11:00 CET**

The headline ZEW expectations index edged higher, to **-13.4** in February, from -15.0 in January.

- **D: Construction, Eurozone (12) 11:00 CET**

Construction output in the Eurozone fell **0.4%** month-to-month in December, driving the year-over-year rate down to +0.7%, from a revised +1.1% in November. A big fall in Germany was the primary driver, offsetting gains in Spain and France, but we suspect that it will be revised up next month.

Wednesday, February 20

- **No significant data released.**

Thursday, February 21

- **D: Final Inflation, Germany (1) 08:00 CET**

Headline inflation likely dipped by 0.3pp to **1.4%** in January, in line with the initial estimate. **Consensus: 1.4%**.

- **D: Final Inflation, France (1) 08:45 CET**

We think that inflation fell to **1.2%** in January, from 1.6% in December, in line with the first estimate. **Consensus: 1.2%**.

- **D: Business Sentiment, France (2) 08:45 CET**

The headline manufacturing confidence index likely was unchanged at **103** in February. **Consensus: 103**.

- **D: Advance PMIs, France (2) 09:15 CET**

We think that the composite PMI in France rose to **49.5** in February, from 48.2 in January, driven by a strong rebound in the services index after the odd fall in January. **Consensus: 49.5.**

- **D: Advance PMIs, Germany (2) 09:30 CET**

The composite PMI in Germany likely was unchanged at **52.1** in February. The services index likely fell a bit, but we are betting on a small rise in the manufacturing PMI. **Consensus: 52.0**.

- **D: Advance PMIs, Eurozone (2) 10:00 CET**

We think the composite PMI in the EZ rose to **51.5** in February, from 51.0 in January, lifted by a rebound in services and stability in manufacturing. **Consensus: 51.1**.

Friday, February 22

- **D: Detailed GDP, Germany (Q4) 08:00 CET**

Real GDP likely was **flat** quarter-on-quarter in Q4 in line with the initial estimate. **Consensus: 0.0%**.

- **D: IFO, Germany (2) 10:00 CET**

We think the headline business climate index rose to **99.8** in February, from 99.1 in January. **Consensus: 99.0**.

- **D: Final Inflation, Eurozone (1) 11:00 CET**

Inflation probably slipped to **1.4%** year-over-year in January, from 1.6% in December, in line with the first estimate. The core rate probably rose, by 0.1pp to 1.1%. **Consensus: 1.4%**.

PANTHEON EUROZONE FINANCIAL CONDITIONS DASHBOARD

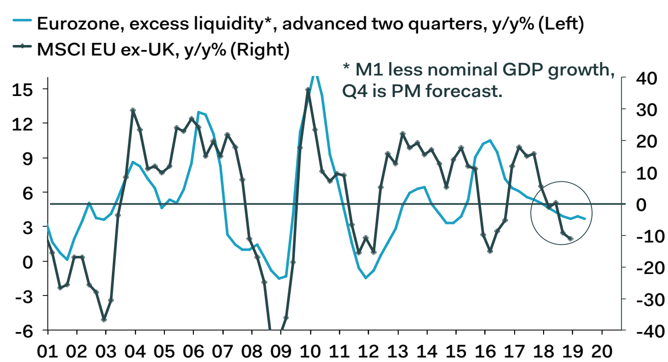
Market	Valuation*	Six month change, %	y/y, %
Eurostx 50	-0.9	-3.9	-5.4
Dax 30	-0.8	-7.5	-9.3
CAC 40	-0.5	-3.6	-2.4

* P/E ratios in standard deviations from 10y average (>1.5 = expensive, <-1.5 = cheap)

Bonds	Curve**	Six month change, bp	y/y, bp
GER (10-2)	-3.7	-29.8	-61.7
FRA (10-2)	-3.3	-11.2	-38.6
ITA (10-2)	-1.5	+53.8	+19.0

** Curve in standard deviations from its 10y average (>1.5 = historically steep, <-1.5 = historically flat)

EUROZONE EXCESS LIQUIDITY VS MSCI EU (EX UK)



EZ equities are still pushing on from the bottom late last year, driven by attractive valuations and dovish comments from central bankers. Excess liquidity indicators still warn of lower returns, but for now the market doesn't care.

PANTHEON'S EUROZONE ECONOMIC FORECASTS (GDP: REAL GDP Q/Q%)

GDP			
Q4 18	0.2	2016 year:	1.8
Q1 19 forecast	0.4	*2017 year:*	*2.5*
Q3 19 forecast	0.3	*2018 year:*	*1.8*
Q3 19 forecast	*0.2/0.3*	*2019 year:*	*1.1*
Q4 19 forecast	*0.2/0.3*	*2020 year:*	*1.0*

CPI y/y, %		Unemployment, %	
January	1.4%	December	7.9%
February	*1.2%*	*January*	*7.9%*
March	*0.9%*	*February*	*7.9%*
April	*1.4%*	*March*	*7.9%*
May	*1.3%*	*April*	*7.8%*