MANUFACTURING A SLOWDOWN

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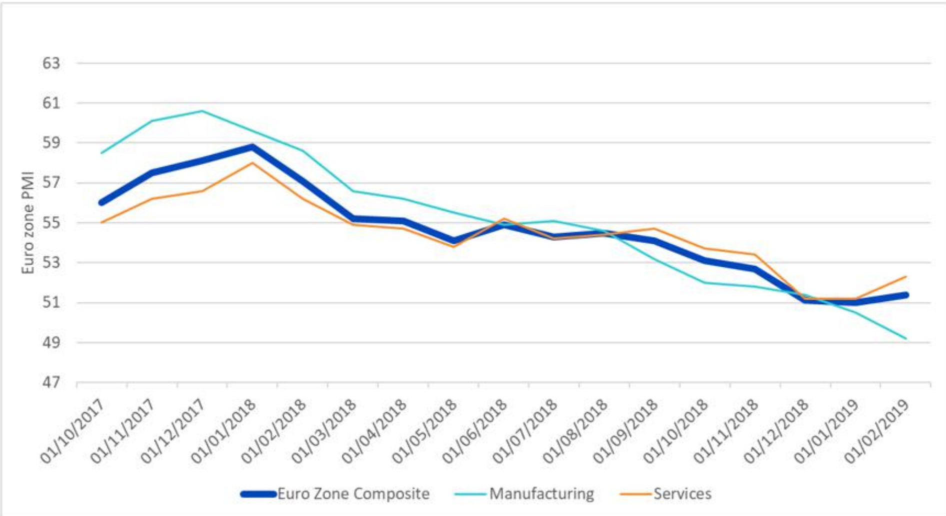
As we enter the final month of the first quarter, investors will be looking for certain answers regarding the health of the Eurozone economy. It has been widely publicized that a slowdown in 2019 looks rather likely and is not being debated. The question then becomes; what type of a slowdown should investors be expecting?

The European Commission (EC) recently weighed in with their projection, and it was basically in line with the consensus forecast. For 2019, the EC looks for Eurozone GDP to decline 0.5 percentage points to +1.3%, essentially right in line with the broader economists' estimate of +1.4%. Within the latter's projection, there are estimates that fall below the +1.0% threshold, with the lowest reading coming in at +0.8%.

Figure 1: Eurozone Purchase Managers Index (PMI)



Source: Bloomberg, as of 22 February 2018.

Historical performance is not an indication of future performance and any investments may go down in value. You cannot invest directly in an index.

Interestingly, the springboard on an individual country basis is not very encouraging. Eurozone Gross Domestic Product (GDP) rose only + 0.2% in Q4, matching the Q3 figure and underscoring the genuine slowdown that is underway. However, Germany's numbers were the real disappointment: 0.0% in Q4 vs. -0.2% in Q3. These results ever so narrowly avoided a technical recession. Italy wasn't as lucky with negative prints in both Q3 and Q4.

At this point, we still do not envision an outright recession for the Eurozone in 2019. A key economic indicator we will be watching are the monthly PMI reports. For February, the 'flash' Eurozone Composite reading inched up a bit to 51.4 vs 51.0 for the prior month, representing the first increase since August of last year. Normally, a break in a downward trend would be viewed as modestly encouraging. However, let's dig a little bit deeper into this economic gauge. The Composite reading actually consists of two underlying components, one that measures manufacturing and the other, services. As the accompanying graph highlights, these two underlying components went in different directions in February. Services rose to a three-month highwater mark of 52.3, but manufacturing lost ground yet again, falling below the '50' threshold (the level that is associate as the marker between expansion and contraction) to 49.2, the lowest level since June 2013.

On an individual country basis, Germany and France both witnessed higher PMI Composite readings. While the manufacturing and services numbers for France were above their January readings, Germany's readings were split like the overall Eurozone's outcome, with manufacturing falling to a low of 47.6.

Conclusion

The Eurozone's PMI uptick provides some hope that a recession will be avoided this year, that is as long as it doesn't reverse course in the months ahead. However, there seems to be no denying the fact that a marked slowdown in economic growth is now in place, led by weakness in the manufacturing sector. This backdrop should keep the ECB from raising rates in 2019.

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