Economic Research

November 2021

Market Monitor – Eurozone

Recovery Clouded by Energy Shortages

Energy worries cloud economic recovery

The eurozone economy continues to recover from a pandemic-induced recession. The preliminary flash estimate of eurozone GDP rose by 2.2% quarter on quarter in Q3, beating market expectation. Eurozone retail sales grew by 0.3% month on month in August and remained unchanged from a year earlier, after a month-on-month dip of 2.6% and an increase of 3.1% year on year in July. The lacklustre performance was due to a fall in food, drinks, and tobacco sales, which decelerated by 1.7% month on month, offsetting the rise in mail and internet orders. Inflationary pressure may be restricting consumer spending. Meanwhile, the preliminary reading of the services purchasing managers' index (PMI) decreased to 54.6 in October, down from 56.4 in September.

Industrial production registered a monthly drop of 1.6% in August, partly due to shortages in raw materials and soaring input prices, with Germany recording one of the largest national decreases at 4.1% month on month. On an annual basis, industrial production still grew by 5.1% year on year in August. Exports increased by 0.3% month on month in August while imports increased by 1.6%, resulting in a trade surplus of €11.1 billion. The manufacturing PMI remained robust, but momentum is softening due to supply chain bottlenecks. The PMI is reported to be 58.3 in October, down from 58.6 in September.

Eurozone inflation is estimated to have increased by 4.1% in October, led by energy prices, which are estimated to have risen by 23.5% annually. Core inflation, excluding volatile food and energy prices, accelerated by 2.1% in October, up from 1.9% in September.

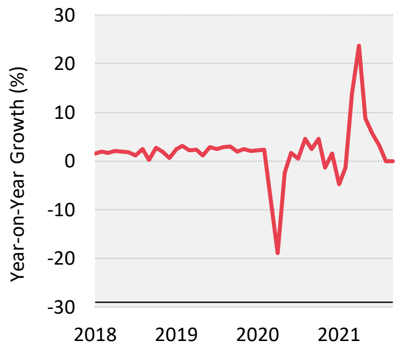
The energy crisis arising from a reduced supply of natural gas from Russia, alongside increased demand following reopening and the need for heating over the coming winter, has caused natural gas prices to soar. In response, the European Commission has proposed a toolbox including direct income support and tax reduction in a bid to protect manufacturers and households from rising costs.

Energy concerns add to pressure on economic activity, which has just started to recover from a pandemic-induced slump.

Shortage of natural gas expected to intensify in winter, further fuelling inflation expectations.

Optimistic sentiment about earnings reports boosts stock market performance.

Eurozone Retail Sales



Source: Bloomberg, data as of 18/10/2021

Supply chain bottlenecks and energy prices – key headwinds ahead

Although the daily confirmed infections of Covid-19 rebounded in late October, Europe continues to implement EU Digital COVID Certificate in order to facilitate safe cross-border travel and economic reopening. Looking ahead to the post-pandemic world, the European Commission is reviewing the EU Budget Rules, also known as the Stability and Growth Pact, which limits governments' borrowing in order to stabilise the euro. Nonetheless, the eurozone governments have rolled out aggressive fiscal policy support to counteract the virus-induced economic recession, which generally accelerated governments' debt above the existing limit of 60% of GDP. Given the post-pandemic reality, the commission is examining ways to revise the budget rules in an attempt to reassure the markets that eurozone debt will remain sustainable.

Looking ahead, the energy crisis and supply chain bottlenecks are challenging eurozone economic recovery in the remainder of the year. The energy issue is not confined to Europe, being shared throughout the world, particularly in China. The increased demand for natural gas throughout Asia at the onset of winter will only exacerbate heating fuel supply shortages and electricity prices in Europe. It is hoped that the lifting of Covid-19 restrictions on social distancing and the upcoming festive season will boost consumer sentiment by the end of the year.

European stocks boosted by investor optimism

The European equity market has rallied with widespread investor optimism about earnings reports outweighing increased concerns about energy and elevated inflation. However, the shortage of natural gas is expected to be exacerbated over the winter if the supply cannot be restored more evenly. The lingering shortage of natural gas will further accelerate energy prices and overall costs for European companies, which will decrease earnings in the coming months.

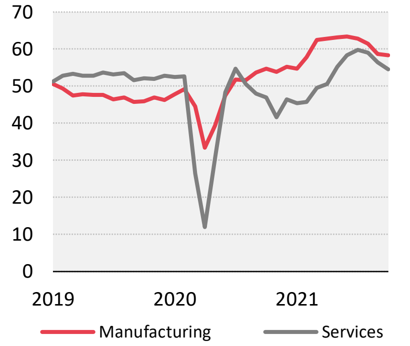
The pan-European Stoxx 600 Index increased by 4.6% between end-September and end-October. During the same period, the German DAX Index rose by 2.8%, while the French CAC Index increased by 4.8%.

Government bond yields edge up further

Despite the fact that the European Central Bank (ECB) will continue its pandemic emergency purchase programme (PEPP) until March 2022, market expectation that the ECB will raise rates by the end of 2022 has not abated, amid continued inflation concerns. Although continuing the stance of temporary inflation, ECB President Christine Lagarde acknowledged that the current phase of high inflation will remain longer than previously expected after the monetary policy meeting in October. The inflationary expectation has also pushed up eurozone bond yields.

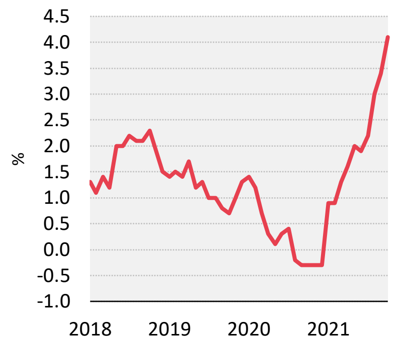
In addition, on 12th October, the European Commission issued its first 15-year NextGenerationEU green bond, raising €12 billion – which will be used to finance member states' green and sustainable projects. By 29th October, German 10-year government bond yields were at -0.106%, up from -0.199% at the end of September.

Purchasing Managers' Index



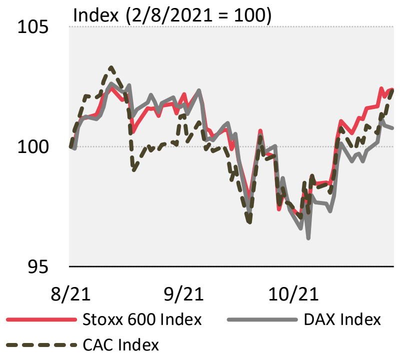
Source: Bloomberg, data as of 4/11/2021

Eurozone Inflation



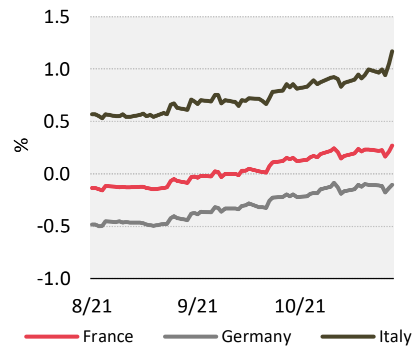
Source: Bloomberg, data as of 29/10/2021

Stock Market Indices



Source: Bloomberg, data as of 29/10/2021

10-Year Government Bond Yield



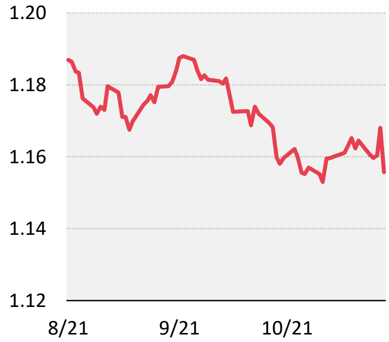
Source: Bloomberg, data of at 29/10/2021

On 29th October, the extra yield demanded by investors to hold 10-year Italian bonds rather than their German equivalents was about 1.28 percentage points, up from 1.06 percentage points at end-September.

Euro under pressure alongside a rebound in US dollar

The euro slightly decreased by 0.19% against the US dollar as of 29th October and was trading at US$1.156, compared with US$1.158 at the end of September. From early to mid-October, the increase of German bond yields has supported the euro. However, the September reading of US core personal consumption expenditure (PCE) price index continued to be higher than 2% target, strengthening the market expectation of earlier rate hikes. The US dollar notably rebounded, resulting in a plunge in the euro at the end of October. The euro is expected to remain under pressure against US dollar in view of the ECB's dovish monetary policy.

Euro against USD



Source: Bloomberg, data as of 29/10/2021

Disclaimer

This document is prepared by The Bank of East Asia, Limited (“BEA”) for customer reference only. Other than disclosures relating to BEA, the content is based on information available to the public and reasonably believed to be reliable, but has not been independently verified. Any projections and opinions contained herein are as of the date hereof, are expressed solely as general market commentary, and do not constitute an offer of securities, nor a solicitation, suggestion, investment advice, or guaranteed return. The information, forecasts, and opinions contained herein are as of the date hereof and are subject to change without prior notification, and should not be regarded as any investment product or market recommendations. This document has not been reviewed by the Securities and Futures Commission of Hong Kong, Hong Kong Monetary Authority, or any regulatory authority in Hong Kong.

BEA will update the published research as needed and as required by the law. In addition to certain reports published on a periodic basis, other reports may be published at irregular intervals as appropriate without prior notice.

No representation or warranty, express or implied, is given by or on behalf of BEA, as to the accuracy or completeness of the information and stated returns contained in this document, and no liability is accepted for any loss arising, directly or indirectly, from any use of such information (whether due to infringements or contracts or other aspects). Investment involves risks. The price of investment products may go up or down. Past performance is not indicative of future performance. The investments mentioned in this document may not be suitable for all investors, and the specific investment objectives or experience, financial situation, or other needs of each recipient are not considered. Therefore, you should not make any investment decisions based solely on this document. You should make investment decisions based on your own investment objectives, investment experience, financial situation, and specific needs; if necessary, you should seek independent professional advice before making any investment.

The views and opinions in this document do not constitute the official views of BEA.

This document is the property of BEA and is protected by relevant intellectual property laws. Without the prior written consent of BEA, the information herein is not allowed to be copied, transferred, sold, distributed, published, broadcast, circulated, modified, or developed commercially, in either electronic or printed forms, nor through any media platforms that exist now or are developed later.

For more information, please visit our webpage at https://www.hkbea.com/html/en/bea-about-bea-economic-research.html. For any enquiries, please contact the Economic Research Department (email: lerd@hkbea.com, tel: (852) 3609-1504, post: GPO Box 31, Hong Kong).