Economic Research February 2022

Market Monitor – Eurozone

Inflation Remains a Major Concern

Inflation continues to surge to a record high

Inflation risk remains, but surge in energy prices starts to ease.

Retail sales growth accelerates despite concerns over Covid-19 outbreaks.

European stocks drop with rising geopolitical risks.

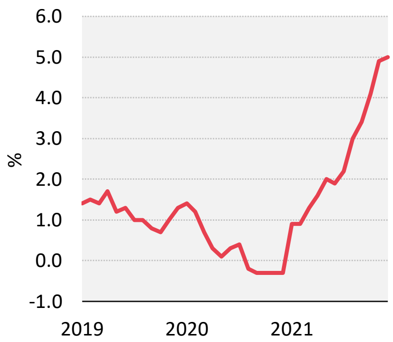
Eurozone inflation remained elevated, defying market expectation of a slowdown. Eurozone inflation advanced further to 5% in December 2021, up from 4.9% in November and higher than the general market expectation of a 4.8% rise. Although the rise in energy prices remained significant, the surge eased off slightly from the rate of growth in November. In December, energy prices accelerated by 26% year on year, marginally down from the 27.5% recorded in November. Meanwhile, supply chain bottlenecks continue to cause delays of materials deliveries, particularly the raw materials needed for manufacturing, leading to price rises in a slew of consumer goods. In December, the inflation rate for food, alcohol, and tobacco accelerated to 3.2%, up from 2.2% as seen in the previous month. Inflation for non-energy industrial goods also rose from 2.4% in November to 2.9% in December.

Eurozone industrial production in October was revised down to a monthly decline of 1.3% from a previously reported 1.1% increase, followed by a 2.3% monthly gain in November. On an annual basis, industrial production decreased by 1.5% in November, driven by a drop of 9.8% in capital goods. On the external front, exports increased by 3% month on month while imports increased by 4.5% in November. Trade balance in the eurozone shrank to a deficit of €1.3 billion, which could be attributed to the rising import value of energy products and increasing demand for goods outstripping growth in eurozone exports. The reading of the eurozone manufacturing purchasing managers' index (PMI) advanced to 58.7 in January 2022, compared to 58 as seen in December 2021.

Eurozone retail sales grew by 1% month on month in November, up from 0.3% growth in October. The growth reading in November also beat market expectation of a monthly decline of 0.5%.

Although the Omicron coronavirus variant has been raging across the continent, some governments such as France and Spain are now moving toward a "living-with-Covid"

Eurozone Inflation



Source: Bloomberg, data as of 20/1/2022

approach involving minimal restrictions. As such, the latest virus outbreak is expected to have a limited impact on people's mobility, and the virus-related economic shock may not be as significant as earlier. If the severity of Omicron does not worsen or deter consumers from making in-person purchases, it is expected that consumption will remain steady in the eurozone in the near term.

Energy price inflation having diverse impacts across the eurozone

The impact of surging energy prices is expected to differ across the member states alongside various government measures. For example, multi-year gas procurement in Germany has helped stabilise costs for consumers. The French government has decided to cap rises in electricity prices at 4% in 2022. Moreover, the government also ordered state-owned utility Electricite de France (EDF) to sell more of its nuclear power to smaller competitors at a lower price. The government measures in some major economies of the bloc are expected to stabilise the cost of electricity for households, limiting the shock of surging energy prices on household finances and consumer goods.

Moreover, some countries in the eastern part of the eurozone seem to be increasingly impacted by the surge in energy prices, and are seeing food prices rise faster. Lithuania and Estonia reported higher-than-average spikes in energy prices, and also saw higher food inflation in November 2021. Lithuania recorded 8.4% inflation in food prices, while Estonia reported a 5.2% increase, exceeding the 2.2% annual growth for the eurozone and 0.4% increase seen in France. Stronger food price inflation in some eastern member states will dampen households' real disposable income, which has been lower across the bloc in general.

Escalating geopolitical tensions drag European stocks

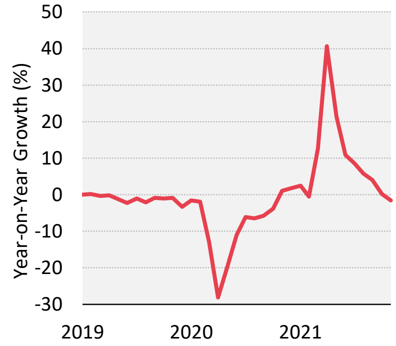
Rising concerns over the escalating tension on the Russia-Ukraine border prompt investors to move away from risky assets, dampening market sentiment. Meanwhile, surging inflation in the eurozone and other advanced economies has brought forward investors' anticipated date for the start of monetary policy tightening. The prospects of rate hikes by some major central banks dampened equities in the healthcare and technology sectors, where valuations are more sensitive to the changes of interest rates. On the other hand, the expectation of higher lending rates in the coming quarters is boosting banking stocks. Banking sector shares in the pan-European Stoxx 600 index recorded a 6.38% gain over the course of January 2022.

The pan-European Stoxx 600 index fell by 3.9% in the period between end-December 2021 and end-January 2022. During the same period, the German DAX index dropped by 2.6%, while the French CAC index decreased by 2.2%.

Government bond yields accelerate with expectation of monetary tightening in the US and improving growth

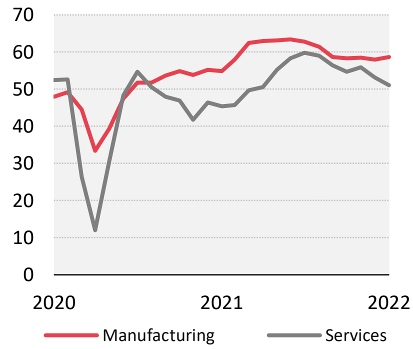
Eurozone government bond yields increased sharply in January 2022, led by the rise of US bond yields due to the expected rate hikes and withdrawal of stimulus by the US Federal Reserve (Fed). Furthermore, it is expected that the German economy will see stronger growth in the coming year in view of a tax cut plan proposed by the new coalition

Eurozone Industrial Production



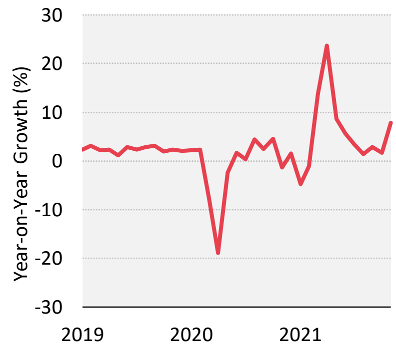
Source: Bloomberg, data as of 12/1/2022

Purchasing Managers' Index



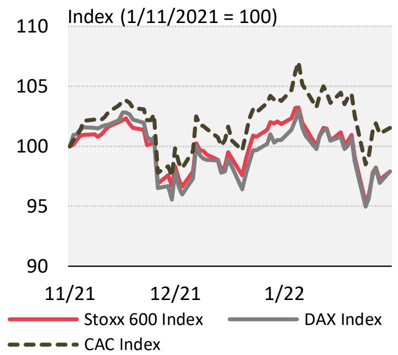
Source: Bloomberg, data as of 4/2/2022

Eurozone Retail Sales



Source: Bloomberg, data as of 7/1/2022

Stock Market Indices



Source: Bloomberg, data as of 31/1/2022

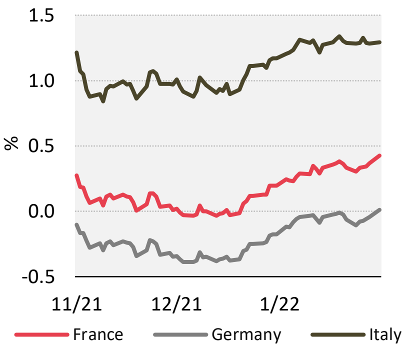
government. The new German government will offer tax relief worth at least €30 billion to individuals and companies. The improving growth sentiment bolstered the uptick in bond yields. Between end-December 2021 and end-January 2022, German 10-year government bond yields increased sharply from -0.177% to 0.011%, a return to positive territory.

As of 31st January, 2022, the extra yield demanded by investors to hold 10-year Italian bonds rather than their German counterparts was about 1.28 percentage points, down from 1.35 percentage points seen at end-December 2021.

Euro depreciates against US dollar

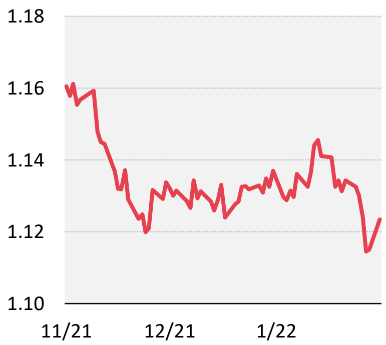
As of 31st January, 2022, the euro depreciated by 1.19% against the US dollar and was trading at USD 1.1235, down from USD 1.137 as at end-December 2021. The escalation of geopolitical risks arising from Russia-Ukraine stand-off has prompted the risk-off sentiment globally, accelerating the demand of US dollar as a safe-haven currency. Moreover, the US Fed also signalled the possibility of sooner- or faster-than-anticipated rate hikes as needed to tame inflation, causing the US bond yields to rise. The increasing risk-off sentiment and expectation of US monetary policy tightening have fuelled the strength of the US dollar, inducing the euro to weaken.

10-Year Government Bond Yield



Source: Bloomberg, data of at 31/1/2022

Euro against USD



Source: Bloomberg, data as of 31/1/2022

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