

Market Monitor – Eurozone

Persistent Headwinds Continues to Cloud Economic Outlook



Various headwinds outweigh reopening growth momentum

After a solid growth in Q2 driven by the reopening and recovery of the tourism sector, Eurozone economic growth weakened again in Q3 amid multiple pressures from elevated inflation, energy crisis, unresolved geopolitical tensions, and rapidly tightening monetary conditions, etc., outweighing the benefits of post-pandemic normalisation.

The Eurozone’s economic growth slowed to 0.2% quarter-on-quarter (QoQ) in Q3 after 0.8% QoQ in Q2. The growth of Spain and Italy, which once benefitted from the recovery of tourism, decelerated from 1.5% and 1.1% QoQ in Q2 to a mere 0.2% and 0.5% in Q3. Meanwhile, Germany and France continued to grow modestly by 0.3% and 0.2% QoQ in Q3. Amid persisting headwinds, the Eurozone economy is expected to stay stagnant or even contract in Q4.

Downward pressure remains on both consumption and production

Amid multiple headwinds, both consumption and production remain under pressure. Eurozone retail sales declined by 1.8% month-on-month (MoM) in October after a modest MoM growth of 0.8% in September. The retail sales in Germany and France even fell by 2.8% and 2.7% MoM. The elevated and widespread inflationary pressure will undoubtedly eat into the purchasing power of household sector, leading to a restrained consumer demand.

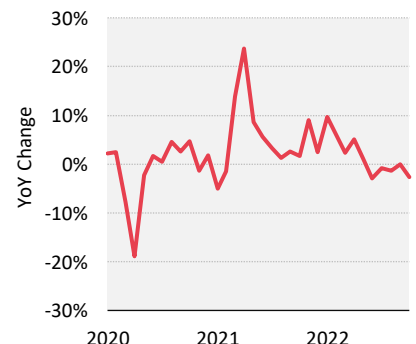
Industrial production expanded moderately by 2.0% and 0.9% MoM in August and September, mainly driven by backlogs, but a turning point for a sustainable growth has yet to come. The production of energy, intermediate goods, and durable consumer goods all recorded negative growth of 1.1%, 0.9% and 0.9% MoM in September respectively, with the decline of energy and intermediate goods production likely to weigh on the production of capital and consumer goods ahead.

Eurozone economic growth slowed in Q3, with various headwinds outweighing demand recovery from reopening.

Retail and industrial sector are expected to stay under pressure.

Persistent headwinds will remain in place.

Eurozone Retail Sales



Source: Bloomberg

Eurozone economy will stay stagnant or contract in the near-term

Looking ahead, persistent headwinds will continue to cloud the Eurozone economic outlook. Energy supply security and elevated inflation remain the major concerns, but its threat has somewhat abated as compared to mid-2022, due to enhanced government support. This includes the EU’s joint purchase for natural gas, improved gas storage, recent proposal of natural gas price cap at €275/MWh, and some European governments accelerating their pace of infrastructure investment for alternative energy, etc. In Germany, the construction of the first LNG import terminal was completed to reduce its reliance of Russian gas. At of end-November, the price of natural gas has retreated by more than half from its late-August 2022 peak. Against this background, the energy price component of the flash Eurozone inflation estimate decelerated notably from 41.5% YoY in October to 34.9% in November. This drove the deceleration of headline inflation from 10.6% YoY in October to 10.0% in November, the first moderation in 17 months. However, high inflationary pressure will continue to squeeze both household and company budgets ahead.

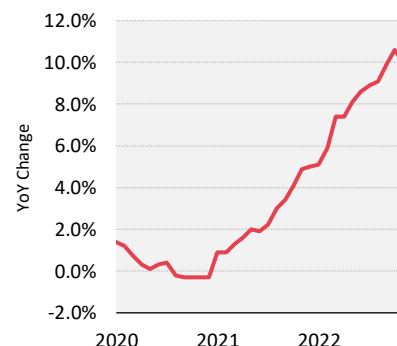
Given that double-digit inflation remains far higher than the European Central Bank’s (ECB) policy target, and the firm core inflation has yet showed any sign of deceleration, the ECB is expected to raise rates by at least another 50 bps and decide the key principles for the reduction of its Asset Purchase Programme (APP) portfolio in December. ECB President Christine Lagarde has warned that some European governments’ fiscal policies could lead to excess demand. This could force monetary policy to be tightened more than necessary. It is still early to expect a turning point for the ECB monetary policy after a cumulative 200 bps interest rate hike since July 2022, with the Eurozone economy expecting to stay stagnant or even contract in the near-term.

However, the Eurozone consumer and business confidence showed initial signs of low level stabilization rather than contraction. The Eurozone manufacturers’ purchasing managers index (PMI) increased from a 29-month low to 47.1 in November, while the Eurozone consumer confidence index also moved up by 3.6 to -23.9, implying that downside risks might not be as bad as feared.

Financial markets recover amid improving market sentiment

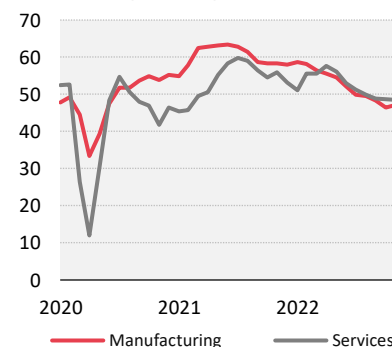
With the expectations of a moderating pace of interest rate hikes by the Federal Reserve (Fed) and initial signs of passing the firmest inflationary pressure, financial market sentiment turned upbeat over the past month. The pan-European Stoxx 600 index rose 6.8%. As of the end-November, the Euro was trading at USD 1.0406, up 5.3% from USD 0.9882 compared to end-October. Germany’s 10-year government bond yield dropped from 2.14% at end-October to 1.93% at end-November. The yield spread between 10-year Italian and German government bonds narrowed to 1.95% as of end-November, down from 2.16% at end-October.

Eurozone Inflation Rate



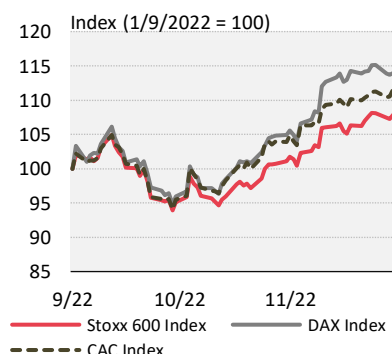
Source: Bloomberg

Purchasing Managers' Index



Source: Bloomberg

Stock Market Indices



Source: Bloomberg, data as of 30/11/2022

Euro against USD



Source: Bloomberg, data as of 30/11/2022

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