BEA 東亞銀行

Economic Research

March 2021

Market Monitor – Eurozone

An Uneven Economic Performance

Eurozone GDP has contracted for four consecutive quarters. It declined 0.6% quarter-on-quarter in Q4 2020, while the economy contracted 5% annually amid tightened lockdown measures ahead of Christmas. Across 2020, the bloc's economy shrank by 6.8%.

An uneven economic performance

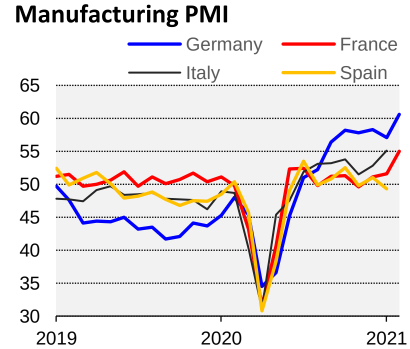
In December, industrial production dropped 1.6% month-on-month, partially reversing the 2.6% month-on-month growth recorded in November. It dropped 0.8% year-on-year. Meanwhile, the eurozone's manufacturing sector is being boosted by exports of goods, which rose by 2.3% annually to €190.7 billion, the first increase since February 2020, marking a full recovery in December. On the other hand, imports registered a 1.3% decline over the same period.

This echoed the manufacturing purchasing managers' index (PMI), which showed a robust preliminary reading of 54.8 in January. Yet the performance varied across nations. Germany and Italy have seen a continual expansion since July last year, with PMIs reaching 57.1 and 55.1 respectively. France was lagging behind but still achieved an expansionary reading of 51.6 in January. However, Spain continued to struggle with contraction at 49.3, partly due to Storm Filomena which disrupted production.

Meanwhile, the eurozone's services sector failed to match the resilience of its manufacturing. The services PMI dropped to 44.7 in February, down from 45.4 in the prior month and well below the threshold of 50.

- **Eurozone's manufacturing sector continues to recover, with Germany and Italy performing well, while Spain is still struggling.**
- **The services sector failed to match the resilience of the manufacturing sector. The market concerns that a slow vaccination rollout will extend Europe's lockdowns and drag its economic recovery.**
- **European shares gained despite lacklustre economic data. Government bond yield rose, while euro was weak.**

Manufacturing PMI



Source: Bloomberg, data as of 25/2/2021

Cause is slow vaccination

The lacklustre performance of the services sector coincides with market concerns about a slow vaccination rollout in EU which has caused Europe's lockdowns to be extended. The EU aims to inoculate 70% of its adult population by this summer. However, the target seems elusive given delays in vaccine delivery and sluggish distribution. By 23rd February, about 6.4% of the EU population was injected with Covid-19 vaccines, compared with 27% in the UK and 19.7% in the US.

Amidst the worsening pandemic situation at the beginning of the year, a double-dip recession is becoming more likely in Q1 2021. The European Commission lowered its 2021 eurozone forecast to 3.8% growth, down from 4.2% as projected previously. The 2022 outlook was raised to 3.8%, up from 3%, with the assumption that mass vaccination campaigns will soon be under way. The prolonged downturn may leave longer-term economic scars however, including a weakened corporate sector, long-term unemployment, and increasing social inequality.

European stocks see gains amid global economic revival

European shares gained with hopes of economic recovery despite lacklustre domestic economic data. The US and the UK have sped up their Covid-19 vaccination programmes, while the global Covid-19 infection rate has dipped steadily and raised hopes of a global economic recovery. However, the recent surge in US treasury yields has dampened the global equity market.

The pan-European Stoxx 600 Index was up by 2.3% between end-January and 26th February. The German DAX Index was up 2.6%, while France's CAC Index was up 5.6%.

Government bond yields follow US treasuries

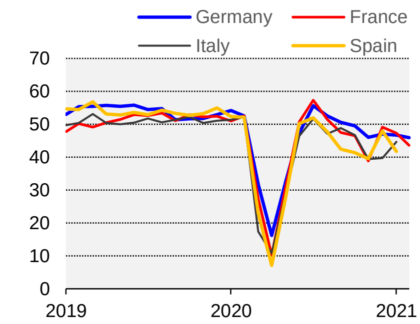
German and French government bond yields rose to the highest levels since September 2020 alongside rising yields of benchmark US treasuries. There was a brighter economic outlook globally and a pick-up in inflation as oil prices rose to their highest level in over a year. German 10-year government bond yields rose to -0.26% on 26th February, up from -0.518% at end-January.

Meanwhile, Mario Draghi, the former head of the European Central Bank, has been appointed as Italy's new prime minister. Investors were optimistic that the new appointment could restore political stability in Italy, pushing down its government bond yields. By 26th February, the extra yield demanded by investors to hold 10-year Italian bonds rather than their German equivalents was about 0.9 percentage points, down from 1.05 percentage points at end-January.

Weak euro amid Covid-19 concerns

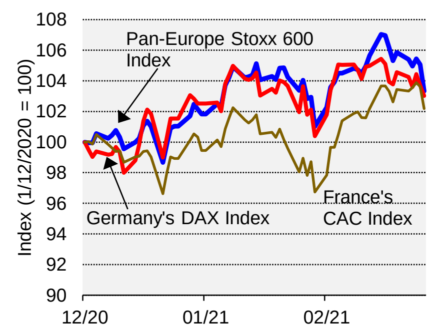
The euro had dropped by 0.5% against the US dollar as of 26th February and was trading at US$1.2075, compared with US$1.2136 as at end-January. Slow progress in Covid-19 vaccination will constrain the pace of recovery for eurozone economies and euro performance in the near term.

Services PMI



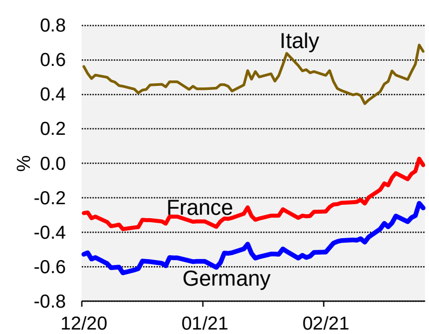
Source: Bloomberg, data as of 25/2/2021

Stock Market Indices



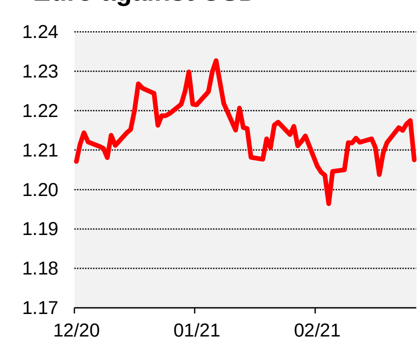
Source: Bloomberg, data as of 27/2/2021

10-Year Government Bond Yield



Source: Bloomberg, data of at 27/2/2021

Euro against USD



Source: Bloomberg, data as of 27/2/2021

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