

Economics Group

Special Commentary

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Eroding Eurozone Economic Confidence

Executive Summary

Following a slump in the Eurozone economy in H1-2020, activity data and confidence surveys during the late spring and over the summer showed a relatively quick initial rebound. While policy fundamentals still appear supportive for growth, a renewed increase in COVID-19 cases and a softening in recent data have raised some concerns. We still expect a firmer Eurozone economy and currency over time, but recent data clearly suggest risks around our outlook are tilted to the downside.

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Eurozone Manufacturing Holds Up, but Service Sector Stumbles

The COVID-19 outbreak and associated lockdown measures took a severe toll on the Eurozone economy in early 2020 as GDP slumped 15% in the first half of the year. However, since spring we have become increasingly more hopeful on Eurozone economic prospects given the actions of monetary and fiscal policymakers, and as activity data and confidence surveys have shown a relatively quick initial rebound from the deep downturn.

However, that more hopeful outlook has faced some questions in recent weeks. Retail sales unexpectedly declined in July, while the August services PMI dipped sharply to 50.5. Meanwhile, after the spread of COVID-19 slowed across the Eurozone during the summer months, the daily increase in new cases has jumped again as we enter the fall and is now above the peak seen in March/April (Figure 1). The rise in cases has raised concerns that at least the partial re-imposition of lockdown restrictions could restrain the rebound and lead to a disappointing pace of recovery.

Figure 1

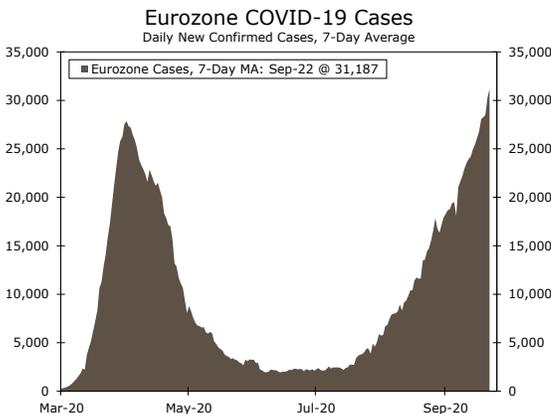
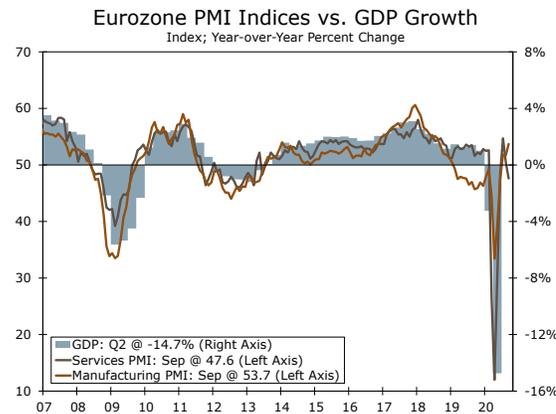


Figure 2



Source: Bloomberg LP, Datastream and Wells Fargo Securities

Against this backdrop, today’s Eurozone September PMI indices were closely scrutinized by market participants. In particular, the services PMI showed further weakness, falling into contraction territory at 47.6. The new business component fell to 47.7 and the employment sub-index eased to 47.6, both consistent with declining activity. By country, Germany’s overall services PMI fell to 49.1 and France’s services PMI fell to 47.5. The Eurozone manufacturing PMI fared better, rising to 53.7,

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with an increase in the new orders component to 57.1, but the employment sub-index, like the service sector, was also in contraction territory.

We believe that underlying policy fundamentals remain growth supportive, with Italy, France and Germany among the countries announcing further fiscal stimulus in recent months. We also believe European governments will be hesitant to re-impose the widespread, large-scale lockdown measures seen earlier this year. That said, with less confident businesses and households, and the potential imposition of further partial restrictions present downside risks to our outlook for the Eurozone. Specifically, the risks to our GDP growth outlook of 8% quarter-over-quarter for Q3-2020 and our longer-term forecast of a 5.3% increase for calendar year 2021, are both tilted to the downside. There is also a risk that the euro appreciates even more gradually than we currently expect over the medium-term.

***Underlying
policy
fundamentals
remain growth
supportive.***

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