Economics Weekly

Bank of Ireland

PMIs add to concerns on health of Euro Area economy

This week's composite PMI at 49.7 in October, served to accentuate fears on the Euro Area's growth prospects for 2025. In this context, the ECB is expected to revise down its projection for 1.3% GDP growth in 2025 so markets are fully pricing in a further 25bp rate cut at the December 12th policy meeting, the deposit rate then expected to fall below 2% by end-2025. At its root, the weak Euro Area economy reflects the past tightening of monetary policy, but also that consumer spending has not yet picked-up as real household incomes have started to grow again. However, there is growing concern the European manufacturing sector, specifically in Germany, now faces more intense competition from China. The IMF has estimated this competition could reduce Euro Area GDP by 0.3% over the medium-term (vs baseline projections). Here, the October 4th decision by EU countries to allow the European Commission impose tariffs up to 35% on Chinese EV car imports will only be a partial panacea. European car producers will still need to compete in important, growing developing markets, including China itself.

PMI surveys indicate Euro Area economy contracted for second successive month in October: Today's (October 24th) composite PMI reading for the Euro Area was 49.7, indicating the private sector is still contracting. The on-going deep slump in manufacturing (45.9) more than offset a soft expansion in services (51.2). Further, new orders fell for a fifth consecutive month and firms cut employment at the sharpest pace in almost four years. The two largest economies, France (47.3) and Germany (48.4) were the main source of the malaise, the rest of the Euro Area countries seeing a soft expansion. The only silver lining to the PMI surveys were that inflation pressures continue to dissipate, both Euro Area input and output prices saw their softest increase in October for three-to-four years.

Doubts on Euro Area's growth prospects have led markets to expect ECB rate cuts: The ECB's September macroeconomic projections were for 1.3% Euro Area GDP growth in 2025. Specifically, a consumer led recovery was expected, given wage growth (4%) in excess of HICP inflation (1.7%) is now driving real income gains. However, the news the household savings ratio rose to 15.7% in Q2 2024 has highlighted the risk uncertain macroeconomic conditions could hold back spending. Indeed, ECB President Christine LaGarde's statement following the ECB's October 17th decision to cut rates by 25bps, acknowledged the risks to the outlook were now '*tilted to the downside*'. The forward overnight index swap (OIS) curve now falls to 1.8% by end-2025, signaling expected ECB rate cuts through next year.

Germany lagging behind: Fear's on Europe's growth prospects have centered on Germany, expected to see flat GDP growth in 2024. The Bundesbank expects a shallow technical recession (two-quarters of negative growth) through Q2 and Q3 2024, both likely to see -0.1% declines. This weak performance has reflected fiscal consolidation and falling real estate prices. Also, Germany's manufacturing sector is concentrated in the production in capital goods and vehicles and more exposed to higher interest rates and the volatile global cycle in investment spending. However, this time around concern has grown that Germany's manufacturing sector also faces structural problems, more intense competition from China in high-tech sectors such as EV car production, beyond the usual cyclical pressures.

Car production a substantial headwind for Europe: The International Monetary Fund's (IMF) October World Economic Outlook highlighted Chinese competition in car production will be a headwind for Europe. As the EV market has grown to 18% of total output, China now accounts for 38% of global car production, as Germany has lost market share (see chart). The IMF calculated under realistic EV market penetration scenarios, coupled with China continuing to enjoy cost advantages, that Euro Area GDP may fall by 0.3% in the medium-term (vs baseline projections). On October 4th the EU voted to impose tariffs up to 35% on Chinese EV car imports, which may dilute competition for European car producers in their home market, but will not apply in important growing global markets including China itself.

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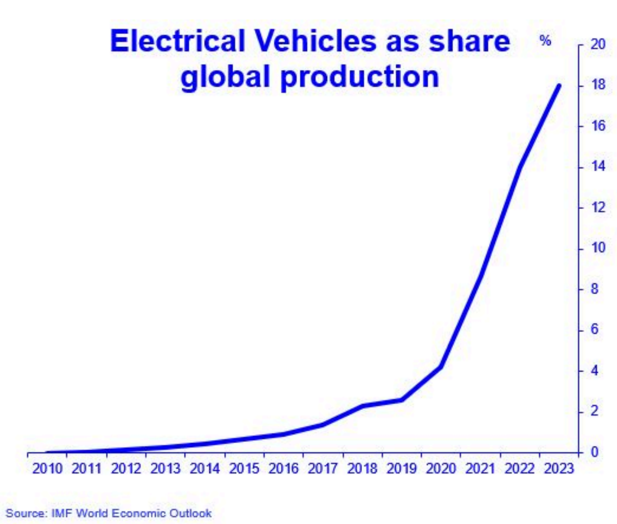

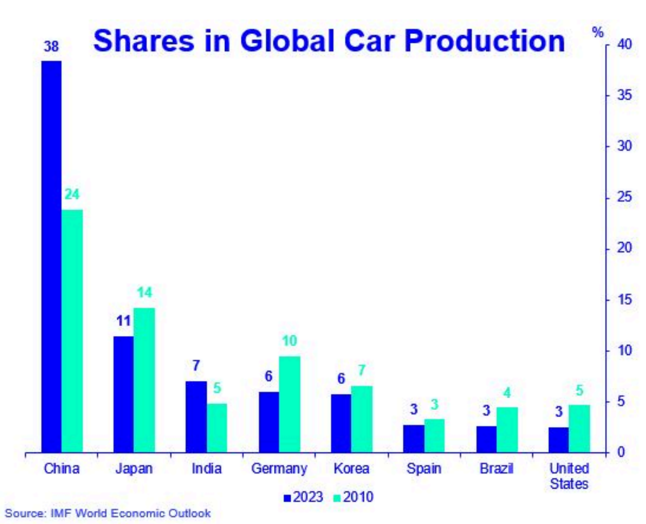

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