

FRANCE, GERMANY, EUROZONE: READING THE RECESSION IN THE PMI LEAVES

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Eurozone March PMIs are “old news” for financial markets but they reiterate the historical proportions of the economic setback currently underway, with many survey components reaching all-time lows. While

a dramatic setback in Eurozone manufacturing was widely expected amid the COVID-19 crisis and already largely priced in by financial markets, today's release still underlines the swiftness and severity of the resulting economic downturn. The composite PMI for the currency area fell to 31.4 points – a historical low and comparable to the decline in Chinese PMIs in early 2020. Similarly, the magnitude of the March decline of 20.2 points was unprecedented. Within a month's time, the Eurozone PMI went from signaling a gradual recovery to a full-fledged economic setback à la 2008/9. The decline was particularly pronounced for the services sector PMI, which reached an all-time low of 28.4, declining by 24 points. Record falls in new orders and expectations of future output, as well as the sharpest decline in employment since July 2009, suggest that there will clearly be more pain ahead.

Eurozone recession a forgone conclusion, with GDP set to decline -1.8% in 2020. Drawing on the experience of China, we modeled a three-month shock with a one-month full lockdown and a partial, u-shaped recovery thereafter, in our baseline scenario. We also took into account the mitigating effects of policy bazookas. Overall, we expect a negative Q1 (-0.9% q/q) in the Eurozone, driven by the impact of confinement measures on economic activity in China and the first containment policies also implemented in most European economies. We expect the trough to be reached only in Q2, with real GDP down by close to -3% q/q. Assuming containment measures are successful, we expect a partial u-shaped rebound in economic activity in H2 2020. Overall, we expect Eurozone GDP to contract by -1.8% in 2020.

Could it be worse? Downside risks continue to loom large. A more protracted health crisis with possible reinfections cannot be ruled out. This would also mean borders stay closed and intermittent domestic confinement prevails. As Italy and Spain have already announced a lockdown extension, we have calculated the negative impact of a two-month lockdown period on key Eurozone economies. In this case, the contraction in 2020 Eurozone GDP growth could exceed -4% in 2020

Chart 1: Length of confinement period & real GDP growth in 2020

Real GDP growth in 2020	1 month of confinement	2 months of confinement
Eurozone	-1.8%	-4.4%
Germany	-1.8%	-5.0%
France	-1.3%	-3.1%
Italy	-3.5%	-6.0%
Spain	-0.8%	-3.8%

Sources: Refinitiv, Allianz Research

Germany: The downturn is coming and it is coming fast... The composite PMI dropped from 50.7 points in February to 37.2 points in March, reaching the lowest level since February 2009. The decline was driven in particular by the services PMI, which at 34.5 reached a historical low, underlining how aggressive confinement measures have already started to bite. Meanwhile, the manufacturing sector also recorded a significant setback with production falling at the fastest pace since early 2009. For Q1 we expect a decline in German GDP of close to -1% q/q.

...the worst is not behind us, though, as the full impact of tougher confinement measures implemented in recent days is probably not fully accounted for. A further pronounced decline in German PMIs in the month of April is highly likely. The sharp setback in German production and new orders, with export orders dropping at the fastest pace since April 2009, has also seen companies cut labor at the fastest pace since May 2009. These puzzle pieces are in line with our baseline scenario, which sees the trough in economic output reached only in late Q2 following a contraction of close to -3% q/q. As containment measures prove successful and the economy gradually returns to normality, we expect to see a partial rebound in economic activity in the second half of 2020. Overall, in 2020, the economy will contract by -1.8%. In the case that confinement measures are implemented for an additional month – i.e. till mid-May – we expect German GDP to decline -4.4% in 2020.

France: The record fall in the Composite PMI mirrors the fall in domestic demand and supply due to the confinement measures implemented since mid-March, as well as the impact of the ongoing international trade recession. This reading is consistent with a fall of -1.5% to -2% q/q in business investment in Q1. We expect the fall to gather pace in Q2 (-6% to -8% q/q).

In France, the Composite PMI index has declined by -21.7 points, a record fall driven by strong declines in output in both the manufacturing (-13.4 points to 35.6) and the services sector (-23.6 points to 29). Output in the manufacturing sector has registered a similar decrease as the Chinese Manufacturing PMI in February. This follows the closure of some factories in the manufacturing sector last week and the reduced demand from the significant consumption shock caused by confinement measures in France. We expect consumer spending to have fallen by more than -1% q/q in Q1 and the fall to accelerate to -5% q/q in Q2 on the back of a full month of "pause". Should the duration increase to two months, consumer spending would register a fall of close to -9% q/q in Q2, with GDP growth expected to fall by -3.1% in 2020 (against -1.3% in a one month of confinement

scenario). New orders have fall at the fastest pace since the series exists, while the new export orders have also been depressed. Indeed, external demand is significantly impaired as more than two thirds of the world economy is confined and European borders are closed. Consequently, the delivery times for goods continued to increase, similar to what we have seen in China in February. In addition, in several manufacturing sectors where demand has been severely impacted (e.g. automotive, machinery and equipment, metals), the level of inventories will continue to increase going forward. Already in March, we have seen a strong increase in the inventories-to-new-orders ratio to above 1.5, levels last recorded during the 2009 crisis. Lastly, there were first signs of a deterioration in firms' profits as supply shortages drove input prices higher while the demand shock reduced output prices. We expect this trend to continue in the month of April along with the confinement measures.

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