

Is a painful destocking in stock for European corporates?

Eurozone inventories hit their highest level since the 2012 crisis

- In March 2019, the Eurozone's inventories-to-new-orders ratio¹ reached a new peak, its highest level since the 2012 crisis, and well above the rest of the world.
- **Global uncertainty and frontloading activities**² account for almost **30% of the increase**. Euler Hermes estimates that inventories are currently between 20% and 30% above what is considered a normal level.
- Euler Hermes shows that the current increasing deviation of the inventory-to-orders ratio from its average would drive prices down by -0.2pp in 2019 and by -0.1pp in 2020. In addition, **inventories are likely to subtract -0.3pp from Eurozone GDP growth in 2019** (to +1.2%) before a catch-up in 2020 (+0.1pp).

Paris, June 27th 2019 – A new study, jointly produced by Euler Hermes Economic Research and Euler Hermes Rating, points out the unusually high level of inventories in the Eurozone since mid-2018.

Read the study: TRIBRating Credit Research - [Painful destocking in sight for European corporates](#)

The inventories-to-new-orders ratio (based on the Manufacturing PMI) is rising worldwide, but the Eurozone's ratio **reached a new peak of 1.13 in March 2019**, its highest level since 2012 and the highest in the world. A ratio above one usually suggests a disruption and calls for an adjustment.

Unusual stockpiling since mid-2018

The inventories-to-new-orders ratio has been steadily increasing in the Eurozone since the end of 2017. In the manufacturing sector, Days Inventory Outstanding (DIO), which indicates how long it takes on average for a company to turn its inventory into sales, have increased by four days in 2018, compared to 2017, for both large companies (+4 days, 52 days) and SMEs (+ 4 days, 58 days). Spanish large companies (+ 11 days) and Italian SMEs (+9 days) saw the largest increases.

The accumulation of stocks driven by global uncertainty and lower demand

Euler Hermes explains³ the current Eurozone inventory accumulation through two factors which account for almost 30% of the increase:

The first factor relates to global uncertainty: large manufacturing companies tend to be more integrated in the global supply chain and more exposed to external trade, which has slowed down since the start of the year, thus leading to stockpiling.

Secondly, frontloading activities have also pushed inventories higher as demand proved to be weaker than expected.

What's the impact on growth?

"A majority of European companies in the manufacturing sector surveyed in June 2019 assessed their level of stocks as "being too large"; which usually turns out to be expensive as stockpiling binds financial resources and warehouse space, leading companies to reduce their inventory level through

1 based on the Manufacturing PMI: Purchasing Managers' Index

2 concentration of costs or benefits of a project in early period

3 Euler Hermes' model looks at total investment growth (y/y), terms of trade (export prices/import prices y/y), a proxy of company production frontloading (the spread between y/y change in manufacturing production and retail sales) and the variation of the global uncertainty index.

production cuts and discounts in prices”, says **Kai Gerdes, Director, Head of Analysis at Euler Hermes Rating**.

Based on the negative relationship between production and level of inventories, Euler Hermes looked into forecasting the adjustment in industrial production on the basis of Eurozone companies’ assessment of their level of stocks in the sector.

“While the trend is clearly on the downside, we expect the production of intermediate goods to suffer the most as the inventory accumulation has been the strongest in this segment (-3% y/y expected by Q3 2019)”, says **Ana Boata, Senior Economist for Europe at Euler Hermes**.

Euler Hermes’ VAR model⁴ shows an impact on **inflation of -0.2pp in 2019 and -0.1pp in 2020** can be expected. The inventory accumulation could also subtract **-0.3pp from real Eurozone GDP growth in 2019, reducing it to +1.2%**.

What is TRIBRating?

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Press contact

EULER HERMES GROUP




Jean-Baptiste Mounier
+33 (0)1 84 11 51 14
jean-baptiste.mounier@eulerhermes.com

FOOTPRINT CONSULTANTS

Cécile Jacquet
+33 (0)1 80 48 14 80
cjacquet@footprintconsultants.fr

Quentin Giudicelli
+33 (0)1 80 48 14 80
qgiudicelli@footprintconsultants.fr

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⁴ The VAR model studies the reaction of growth and inflation to a typical (one standard deviation) positive shock of inventories (an over-accumulation of inventories triggering a negative adjustment of growth thereafter)

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