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MACRO MORNING BRIEFING

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Demand Weakness Clear In Eurozone Imports

Eurozone import data does not bode well for growth outlook

- Import levels and volumes remain depressed at the lows
- All components, from energy to consumer and manufactured goods, are contracting
- Exporters to Eurozone could also face challenges up ahead

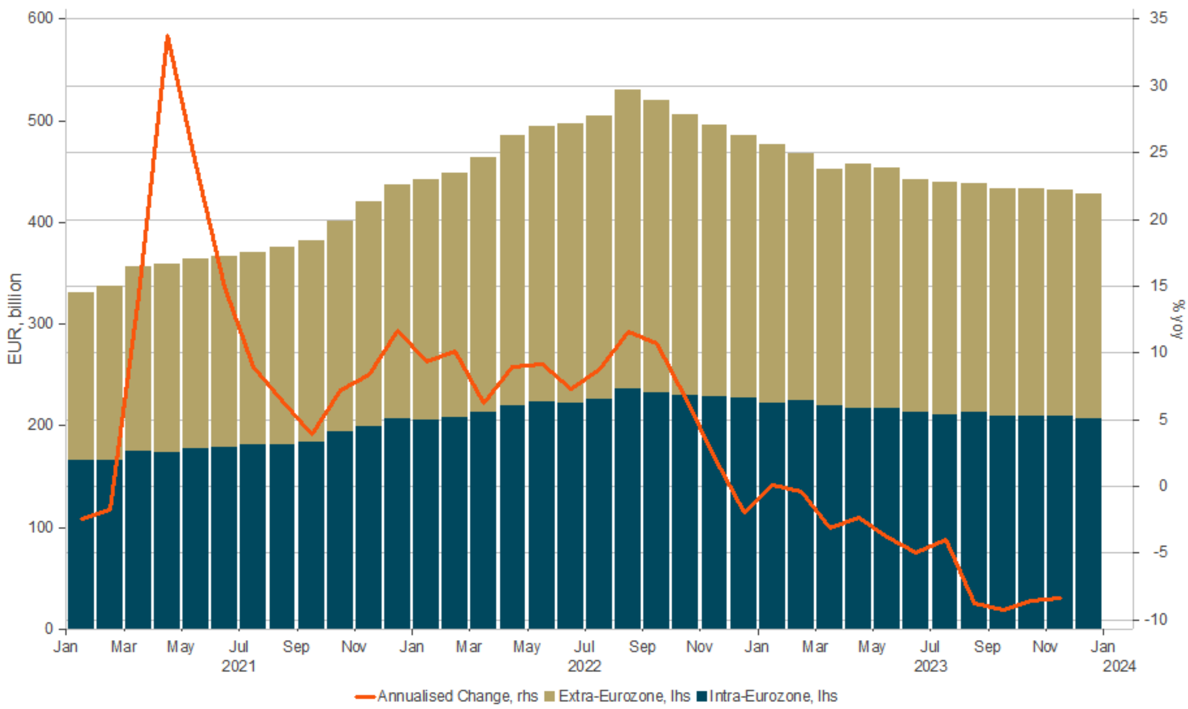
Soft data stabilisation in Eurozone does not point to turn in cycle

Re-pricing of the Federal Reserve's policy path has dominated proceedings over the last few weeks. For some key FX pairs, however, the prospect of a "higher for longer" federal-funds rate has not translated into a stronger US dollar. This is particularly the case for EURUSD, which has returned to the higher end of recent ranges, supposedly on expectations that the Eurozone economy has finally turned the corner. Rate expectations for the European Central Bank have moved commensurately, even though the Governing Council itself is far more divergent on their cycle compared to Fed peers.

We acknowledge that the bar is presently high to factor in additional “bad news” for the European economy. After all, manufacturing PMIs remain in deep contraction territory. However, there are also signs that services demand may start to recover, which would give credence to ECB hawks’ view that real income growth is robust and offsetting disinflationary pressures from other sectors. Even so, we believe that divergence between the ‘soft’ survey data and ‘hard’ realised activity numbers, at least based on the Q4 releases, is growing. Even for manufacturing-based economies with high savings rates, the rate of change in imports for different trade components is a good indication of demand across different segments of the economy – and the indications are troubling.

Simply looking at aggregate imports on an intra- and extra-Eurozone basis, nominal values have fallen in all but one month since September 2022. The pace of annualised decline appears to have stabilised after threatening to fall into double-digit contraction, but there is precious little sign of a pick-up which would indicate demand improvement. The weakness in intra-Eurozone imports is particularly problematic. Much of this trade would be in intermediate goods before re-exporting outside of the Eurozone. Global conditions are beyond the Eurozone's control, but the knock-on effect is clear for domestic growth in a manner which may have less of a euro impact via balance-of-payments effects. For economies which are intermediate, rather than finished, goods producers, the urgency for monetary accommodation is higher due to their place in the cycle.

Exhibit #1: Eurozone Imports (intra- and extra-) And Growth



Source: Macrobond, BNY Mellon

Customs data show that both manufactured products and consumer goods imports have also been contracting since the beginning of last year. The hawks on the Governing Council may need to take note of such trends. Even though their view that current wage growth in the services sector remains too high for comfort is valid, it may not prove inflationary if incremental gains in household cashflow are diverted into savings rather than consumption.

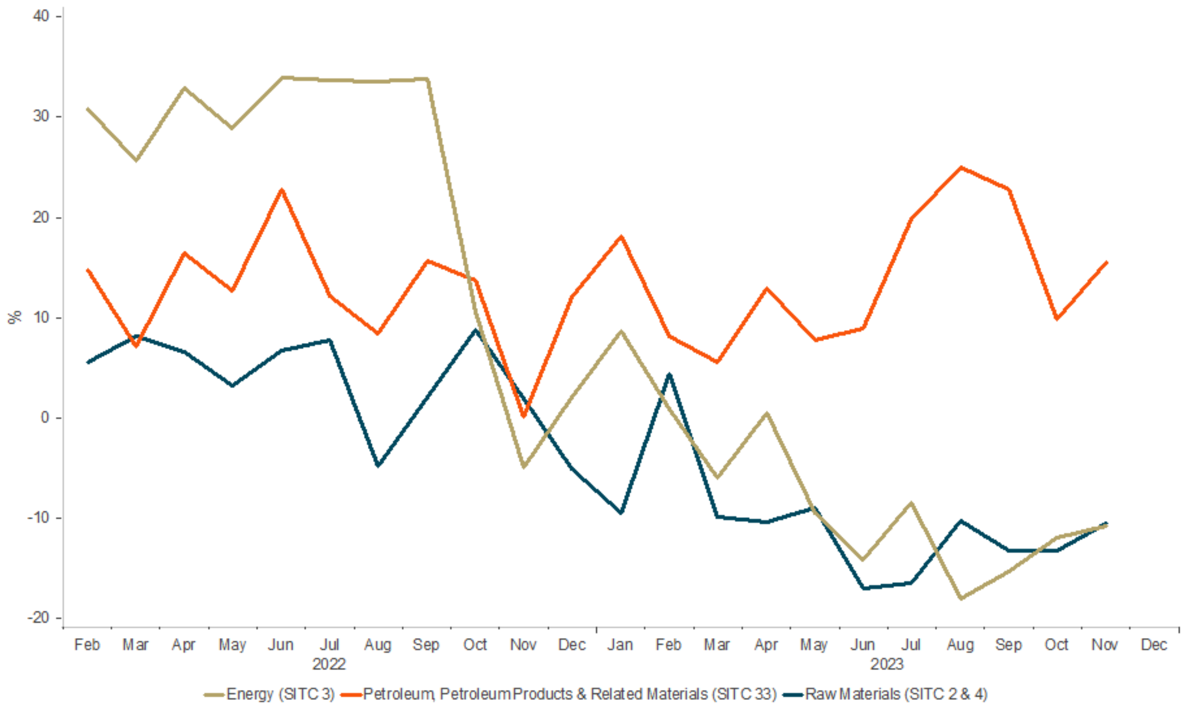
Eurozone services PMI printing a flat 50.0 for February was the first non-contraction month since July last year and a key factor behind improvement in the euro's outlook. Even so, no longer contracting strongly is very different to demand picking up. Furthermore, greater savings and import weakness for households also implies a better balance-of-payments position. While this may initially prove beneficial for the euro, pass-through risk will start to work in the opposite direction and justify a less-hawkish stance. Meanwhile, the Eurozone's financial account may also struggle to reconcile a stronger euro with current performance in European equities, to which global earnings sensitivity is far stronger compared to US peers.

Exhibit #2: Eurozone Imports By Type

Source: Macrobond, BNY Mellon

The import situation with raw materials and energy is similarly weak and symptomatic of softer growth. Prices may have declined as well, but the data pertain to import volumes. The one major exception is the petroleum and petroleum products component within energy. Based on timelines, it is evident that the Eurozone is now simply recovering from the cessation of oil and gas imports from Russia and finally managing to establish new energy-supply lines. These changes are well-documented and testament to the Eurozone's resilience during times of extreme stress. However, this should not detract from the broader growth drag in place, as reflected in energy demand.

Exhibit #3: Eurozone Energy & Raw Materials Imports

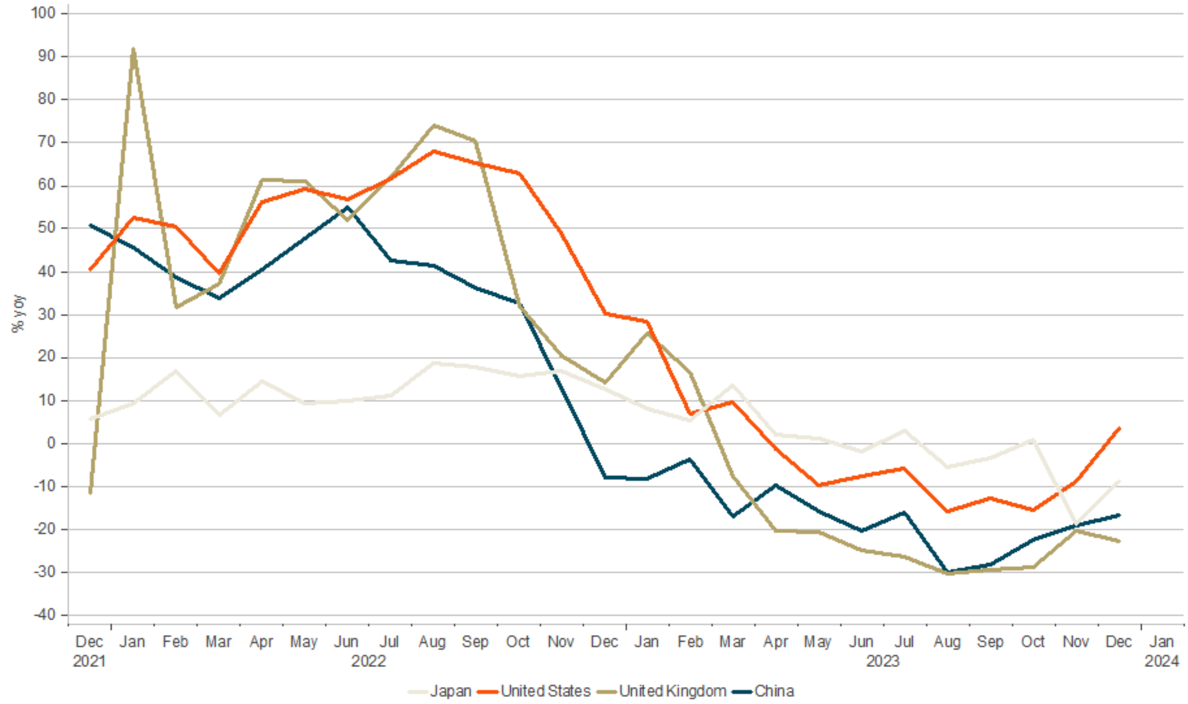


Source: Macrobond, BNY Mellon

Import source also matters, not just in gauging the state of the Eurozone economy but in that of its main trading partners as well. Exhibit 4 shows the rate of change in Eurozone imports from key trading partners: the US, UK, China and Japan. These four economies comprise much of the supply chain for both end-consumers and manufacturers. Every single partner is also currently showing contraction in their exports to the Eurozone in nominal terms, and by double-digits in the cases of the UK and China. At face value, it is clear that the rate of change has softened, indicating that Eurozone demand has perhaps bottomed out. The high valuation for the EUR at present also helps with purchasing power. Where applicable, if cheaper substitutes can be found elsewhere then imports will rise – potentially another headache for Eurozone manufacturers, especially considering the level of EURJPY and direct competition with Japan in the high-value added manufacturer sector high.

The improvement appears to be the most significant for imports from the US. Trade remains a secondary driver of US growth compared to domestic demand, but in areas such as technology and even energy, where the US is increasingly enjoying a competitive advantage, the improvement for the US globally should not come as a surprise. However, given the production and taxation agreements of US-based multinationals, we suspect that the reported earnings are perhaps lower or accounted for within intra-EU trade, which may not be reflected in conventional commerce-related current account items. Although EURUSD is at the high end of recent ranges, high US rates is a supportive element for earnings repatriation. On the other hand, corporates may also wish to wait for potential changes in corporate tax policy, which could also change incentives of earnings domicile.

Exhibit #4: Eurozone Import Change By Exporter



Source: Macrobond, BNY Mellon

For all the talk of China's newfound manufacturing prowess in the auto sector and the threat to traditional European manufacturers, imports from China have been lacklustre: Eurozone imports from China are currently running at -16.6% y/y in nominal terms. While this is a reflection of weak Eurozone demand across the supply chain, it also raises questions for China's industrial strategy. If "high-quality" exports to the world, backed up by a resilient supply chain, is the way forward for China's growth, there must be end-demand on the other side. The US market could prove difficult for subjective reasons, and purchasing power in the rest of the world still lags the Eurozone, Europe and wider EU. If the lack of export growth is due to pricing, then further price declines – as we are seeing in China's Battery Electric Vehicle (BEV) industry yet again – are inevitable for its exports. Any escalation in EU-China trade tensions aside, Beijing may need to assess whether such a strategy is conducive to its own domestic income growth. Recent commentary suggests Beijing is re-orienting back to domestic demand. Doing so would seem in everyone's interest.

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